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In the Supreme Court of the United States

OCTOBER TERM, 1977

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

SHELL OIL COMPANY, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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v.

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The Solicitor General, on behalf of the Federal Energy Regulatory Commission,[1] petitions for a writ of

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[1] On September 30, 1977, pursuant to the provisions of the Department of Energy Organization Act (DOE Act), Pub. L. 95-91, 91 Stat. 565, and Executive Order No. 12009, 42 Fed. Reg. 46267, the Federal Power Commission ceased to exist. Its functions and regulatory responsibilities were transferred to the Secretary of Energy and to the Federal Energy Regulatory Commission, which, as an independent commission within the Department of Energy, was activated October 1, 1977. Pursuant to Section 402(a)(1)(C) of the DOE Act, "the establishment, review, and enforcement of rates and charges for the transportation and sale of natural gas" in interstate commerce were "transferred to, and vested in" the Federal Energy Regulatory Commission. The "savings provisions" of

certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, pp. 1a-10a) is reported at 566 F.2d 536. The order of the Federal Power Commission (No. 539-B) (App. C, *infra*, pp. 13a-32a) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on January 20, 1978 (App. B, *infra*). By order of April 11, 1978, Mr. Justice Powell extended the time for filing a petition for a writ of certiorari to May 20, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 52 Stat. 831, as amended, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Whether the production and gathering exclusion in Section 1(b) of the Natural Gas Act denies the Federal Energy Regulatory Commission authority to require certificated producers of natural gas to "observe the standard of a prudent operator" in developing and maintaining delivery of gas from their dedicated reserves, so as to assure the fulfillment of their duty, under their certificates and Section 7 of the Act, to continue interstate service until the Commission authorizes them to abandon that service.

Section 705 of the DOE Act provide for the substitution of the Federal Energy Regulatory Commission for the Federal Power Commission in pending litigation such as this case.

STATUTES AND REGULATION INVOLVED

Sections 1(b), 7(b), (c), and (e) of the Natural Gas Act, 52 Stat. 821, 824-825, as amended, 15 U.S.C. 717(b), 717f(b), (c), and (e), are set forth as Appendix D, *infra*, pp. 33a-35a.

Section 157.41 of the Commission's Rules and Regulations, 18 C.F.R. 157.41 (1977), provides:

> On and after July 30, 1976, all certificates of public convenience and necessity for the sale of natural gas for resale in interstate commerce shall be conditioned as follows:
>
> All persons making jurisdictional sales pursuant to the authority granted by this certificate are hereby given notice that the contractual obligations between the buyer and the seller are incorporated into the certificate obligations, and that the certificate is further conditioned to require that the seller shall observe the standard of a prudent operator to develop and maintain deliverability from reserves dedicated hereunder.

STATEMENT

A producer seeking to sell natural gas for resale in interstate commerce must first obtain from the Commission under Section 7(c) of the Natural Gas Act, 15 U.S.C. 717f(c), a certificate of public convenience and necessity. The Commission will grant the certificate if it finds "that the applicant is able and willing properly to do the acts and to perform the service proposed" and to conform to the requirements of the

Act and the Commission's rules, and if it further finds that the proposed service "is or will be required by the present or future public convenience and necessity." Section 7(e), 15 U.S.C. 717f(e). The same provision of the Act authorizes the Commission to attach to the certificate "such reasonable terms and conditions as the public convenience and necessity may require." Section 7(e), 15 U.S.C. 717f(e). Once a certificate has been issued, the certificated service is subject to Section 7(b) of the Act, 15 U.S.C. 717f (b), which provides in pertinent part:

> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission * * * and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

To clarify these requirements and eliminate uncertainty among producers concerning their obligations to maintain deliveries of gas under the Act, the Commission on July 30, 1976, in its Order No. 539-B, adopted the regulation here at issue (18 C.F.R. 157.41 (1977); App. C, *infra*, p. 28a). The regulation provides that on and after July 30, 1976, all certificates of public convenience and necessity for the sale of natural gas for resale in interstate commerce are conditioned "to require that the seller shall

observe the standard of a prudent operator to develop and maintain deliverability from reserves dedicated [under the certificate]" (*ibid.*). The Commission noted that the standard of a "prudent operator" was well-known in the industry and declared it to mean "the standard of what a reasonably prudent producer would do with respect to the drilling completion, workover, recompletion or abandonment of wells." 41 Fed. Reg. 32884; App. C, *infra*, pp. 19a-20a.[2]

The Commission observed that some parties to its proceeding had advanced the argument "that a common term in producer-pipeline contracts called the 'sole discretion' clause permits the producer complete control over deliverability to the pipeline" (App. C, *infra*, pp. 15a-16a). Rejecting this view, the Commission saw a need "to make clear that its certificate conditions * * * are superior to any limitations on Commission authority contained in the contract," and accordingly to address the question of "what standard

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[2] Order No. 539-B was preceded by a statement of policy, codified as 18 C.F.R. 2.83 (1976), that was promulgated in Order No. 539, issued October 14, 1975. Among other things, this policy would have required seller-producers, as a condition of their certificates, to maintain delivery obligations in accordance with their contracts unless changed by certificate amendment. The Commission concluded, however, that its policy statement should be the subject of a proposed rulemaking and accordingly issued Order No. 539-A, on March 26, 1976, opening such a rulemaking proceeding. The order at issue in this case, No. 539-B, reflects the outcome of that proceeding. It repealed the provisions of 18 C.F.R. 2.83 (1976) that were adopted in the original Order No. 539 (App. C, *infra*, p. 28a).

or test of deliverability the producer is required to live up to under the provisions of the Natural Gas Act and the rules and regulations of this Commission" (*id.* at 16a).

In response to allegations that it lacked authority to enforce certificate obligations by imposing conditions on the certificates, the Commission reasoned that "[s]ince the requirement of service continues until the Commission permits abandonment, and since the holder of a certificate from the Commission must comply with the rules and regulations thereof, [the Commission may act] to preserve the integrity of its certification process by conducting an oversight review of an on-going service obligation" (App. C, *infra*, p. 18a). It further stated that since each certificated contract is subject to the abandonment provisions of Section 7(b) of the Act, "if the seller under a certificate is not meeting the delivery obligations of such certificate, there has been either a partial or total abandonment of certificated service which requires Commission approval pursuant to Section 7(b)" (*id.* at 23a).

Compliance with delivery obligations, the Commission thus reasoned, may be enforced by determining whether the natural gas company has acted prudently in the circumstances. Such a standard, the Commission ruled, is implicit in the service obligation incorporated into all existing certificates under *Sunray Oil Co.* v. *Federal Power Commission*, 364 U.S. 137, 156. The Commission concluded that it should adopt a regulation making this pre-existing "prudent

operator" obligation explicit. It therefore promulgated Section 157.41 of its rules, *supra* (App. C, *infra*, p. 24a).[3]

Respondents, the Shell Oil Company and other producers of natural gas, petitioned for review of Order No. 539-B. The court of appeals vacated and remanded the Order (App. A, *infra*).

The court held that the prudent operator condition was excluded from the Commission's jurisdiction by Section 1(b) of the Natural Gas Act, 15 U.S.C. 717 (b). Section 1(b) provides that the Act "shall not apply * * * to the production or gathering of natural gas." The court reasoned that even though the Commission may enforce service obligations contained in producer certificates by preventing producers from ceasing deliveries from fields capable of continued production, and even though it may regulate abandonments (*id.* at 7a), its jurisdiction does not reach "the physical activities, processes, and facilities of production and development" (*ibid.*). The court found that "Order No. 539-B clearly is intended to open the door to FERC involvement into forbidden production activities" (*id.* at 8a). Declaring that to

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[3] Order No. 539-B indicates that the requirement of Section 157.41 that certificates shall contain an express statement of the prudent operator standard applies to certificates "issued on or after" July 30, 1976 (App. C, *infra*, p. 24a). However, because the Commission believes that the prudent operator standard has been implicit in the requirements of the Act, the principle reflected in Section 157.41 applies to all existing certificates as well, whether or not they contain such an express provision. See App. C, *infra*, pp. 20a-23a.

uphold the order "would all but eliminate the 'production or gathering' exclusion and would allow the FERC to encroach on areas reserved to the states," the court held the order to be beyond the Commission's jurisdiction (*id.* at 9a).

REASONS FOR GRANTING THE WRIT

The court of appeals has held that the Commission lacks jurisdiction to adopt and enforce a standard requiring that certificated producers undertake prudent measures to assure continued delivery of gas they have dedicated to interstate commerce. This erroneous ruling may seriously impair the Commission's ability to carry out its responsibilities under the Natural Gas Act.

1. The Commission's rationale is straightforward. It is well established that the Act and the Commission's jurisdiction extend to producers who sell natural gas for resale in interstate commerce. *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672. It is also well established that a producer (or any other certificated seller) has an obligation under the Act to continue the "service" of delivering gas from his dedicated reserves to interstate commerce until the Commission, under Section 7(b) of the Act, permits abandonment of the service, and that this obligation survives any contract obligation the producer may have. *Sunray Oil Co.* v. *Federal Power Commission*, 364 U.S. 137.

In the Commission's view, these requirements necessarily vest in the Commission some jurisdiction over

the physical acts of the producer and the physical operation of the facilities by which certificated service is rendered. To take a clear case, a certificated producer could not evade his delivery obligations under the Act by deliberately failing to replace a broken washer, or to flush a plugged well-choke, that had stopped the flow of gas from his well. In such an event the Commission's statutory authority and responsibility to enforce its certificates would include the authority to institute a proceeding (see 15 U.S.C. 717s) for enforcement of the producer's certificate obligations, notwithstanding that such enforcement would be based on the producer's physical operation (or non-operation) of his facilities.

The Commission's regulation here has made this principle explicit in order to dispel any uncertainty within the industry. The regulation states and clarifies the relationship between the statutory duty to maintain service under a certificate and the means by which that duty is carried out. The Commission's prudent operator standard is an appropriate formulation of the principle, and the Commission's regulation is an appropriate exercise of its power under Section 7(e) "to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require" (15 U.S.C. 717f(e)).

The prudent operator principle embodied in the regulation is important to the Commission's ability

to carry out its responsibilities under the Act. Many producers today have substantial incentives to cease or reduce their deliveries of natural gas to interstate commerce. Because of the present differential between interstate and intrastate rates for natural gas, and the possibility in the future of some form of deregulation or congressionally mandated increases in interstate prices,[4] producers may rationally prefer to leave their gas in the ground in the hope of better prices in the future. And they may seek to achieve this result by attempting a *de facto* abandonment of certificated interstate service. Since the United States continues to suffer from the shortage of natural gas in the interstate market that was noted by this Court in *Mobil Oil Corp.* v. *Federal Power Commission*, 417 U.S. 283, 304, the Commission's authority to prevent such *de facto* abandonment is essential to the performance of its responsibilities under the Act.

2. The court of appeals invalidated the Commission's regulation on the ground that the Commission has no jurisdiction over the producer's physical operation of his facilities, relying for that conclusion on the "production or gathering" exclusion in Section 1(b) of the Act (15 U.S.C. 717(b)). Under the court of appeals' rationale, if a producer in effect

[4] The natural gas provisions of the proposed National Energy Act (H.R. 5289, 8444, 95th Cong., 1st Sess. (1977) now being considered in conference by Congress may contain provisions bearing on the regulatory future of natural gas. The outcome of the legislative discussion, however, is too uncertain to permit meaningful discussion of the proposed legislation as it bears on this case.

abandons a "portion of its facilities" (Section 7(b)) by failing to operate them prudently, the Commission can do nothing to require their continued operation. The Commission can require producers to continue delivery of dedicated reserves under existing certificates only as long as the physical facilities, controlled exclusively by the producers, permit the continued flow of gas. If the producer allows those facilities to fall into disrepair, the Commission is powerless under the court of appeals' ruling to remedy this default, because it involves the physical aspects of the production and gathering process.

That conclusion disregards the purpose and the plain requirements of Section 7 of the Natural Gas Act, as well as this Court's decisions applying the Act to producer transactions. The Court has never held that the production and gathering exclusion in Section 1(b) prohibits administrative action necessary to the achievement of the ultimate purposes of Section 7. Cf. *Permian Basin Area Rate Cases*, 390 U.S. 747, 780. In this case the Commission has found that the achievement of those purposes requires administrative authority over physical operations by producers to the extent necessary to assure that a certificated service in natural gas will be continued until the Commission authorizes its abandonment pursuant to Section 7(b). The Commission's finding is supported by this Court's decisions interpreting Section 7(b). *Sunray Oil Co.* v. *Federal Power Commission, supra*, 364 U.S. at 149-151, 156; *Atlantic Re-*

fining Co. v. *Public Service Commission (CATCO)*, 360 U.S. 378, 389.

As a practical matter, if the Commission lacked such authority producers would be able, through their control of their physical operations, to determine for themselves whether and when to abandon, in whole or in part, the facilities by which they render service. As the Court said in the *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at 777. " '[C]onsiderations of feasibility and practicality are certainly germane' to the issues * * *. [The Court] cannot, in these circumstances, conclude that Congress has given authority inadequate to achieve with reasonable effectiveness the purposes for which it has acted." On the contrary, the "Court has repeatedly held that the width of administrative authority must be measured in part by the purposes for which it was conferred; * * *." *Id.* at 776.[5]

[5] The Court has applied the same principle in other contexts. In *United States* v. *Southwestern Cable Co.*, 392 U.S. 157, 178, and *United States* v. *Midwest Video Corp.*, 406 U.S. 649, the Court upheld the jurisdiction of the Federal Communications Commission to impose certain regulations on cable television on the ground that such regulation was "reasonably ancillary to the effective performance of the Commission's various responsibilities for the regulation of television broadcasting" (392 U.S. at 178). Similarly, the Federal Energy Regulatory Commission's jurisdiction over the physical operation of production facilities, to the extent necessary to maintain the producer's delivery obligations, is at least "reasonably ancillary" to the Commission's undisputed jurisdiction under the Act to regulate the sale of natural gas in interstate commerce.

The "production or gathering" exclusion of Section 1(b) requires no different result. As the court of appeals noted (App. A, *infra*, pp. 7a-8a), early cases under the Natural Gas Act indicated that by virtue of this exclusion the Commission had "no control over the drilling and spacing of wells and the like." *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, 603; see also *Federal Power Commission* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 509-512. But after this Court held in *Phillips Petroleum Co.* v. *Wisconsin*, *supra*, that the Natural Gas Act applies not only to pipelines but also to gas sales by independent producers for resale in interstate commerce, it began a process of reconciling the production and gathering exclusion with the requirements of Section 7 as applied to sales by producers. Thus, in *Phillips* itself the Court noted that the production and gathering exception to the primary grant of jurisdiction in Section 1(b) was to be strictly construed, and further held that Congress never intended that that exception "would substantially limit the affirmative grant of jurisdiction to the Commission * * *." 347 U.S. at 679.[6]

[6] The Court held (*ibid.*, n. 7):

> The committee reports on the bill enacted as the Natural Gas Act, H.R. 6586, 75th Cong., 1st Sess., reveal that a construction of the "production or gathering" exemption which would substantially limit the affirmative grant of jurisdiction to the Commission was not contemplated. After quoting the exemptive clause of § 1(b), the House Report states that:
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> > "The quoted words are not actually necessary, as the matters specified therein could not be said fairly to

Under *Phillips*, the Commission's jurisdiction embraces interstate sales by producers. Under *Sunray*, *supra*, such sales imply "a continuing obligation to perform 'service' imposed by the Act which outlasts the term of a seller's original contract of sale." 364 U.S. at 153. It follows that the production and gathering exception does not deny to the Commission the authority to assure that the deliverability of dedicated reserves is maintained by prudent physical operation.[7]

The court of appeals' holding to the contrary is inconsistent with its own recognition that the Commission may "enforce 'service obligations' contained in the certificates that it issues to producers, preventing producers from ceasing deliveries from fields admittedly capable of continuing production" (App. A, *infra*, p. 7a) (citing *Sunray*), and that the Com-

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be covered by the language affirmatively stating the jurisdiction of the Commission, but similar language was in previous bills, and, rather than invite the contention, however unfounded, that the elimination of the negative language would broaden the scope of the act, the committee has included it in this bill." H.R. Rep. No. 709, 75th Cong., 1st Sess. 3.

The Senate Report adopted and reprinted the House Report on the bill. S. Rep. No. 1162, 75th Cong., 1st Sess.

[7] The Court recognized in *Sunray* (364 U.S. at 156-157) that its holding raised an issue concerning the relationship between the production and gathering exclusion and the service obligation implied in a certificate, but it found that the record did not permit resolution of the issue in that case.

mission may "regulate the 'abandonment of service'" (*ibid.*). More significantly, the holding is inconsistent with this Court's determination of the Commission's responsibilities under Section 7 as set forth in *Phillips* and *Sunray*. The Commission correctly perceived those responsibilities when it held (App. C, *infra*) that under Section 7(b), a seller may not partially or totally abandon its service obligations by failing to undertake reasonable physical measures to maintain delivery of dedicated gas. This "prudent operator" standard is a rule of reason incidental to the duty each producer undertakes when he obtains a certificate to sell his gas for resale in interstate commerce. His "willingness to make the proposed 'sale' * * * must imply willingness to perform the 'service' which it represents." *Sunray*, *supra*, 364 U.S. at 151.[8]

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[8] The court of appeals also suggested, though it did not reach the question, that even if the Commission has jurisdiction to issue such a regulation, the regulation might be invalid because there was no evidence in the record that producers have in fact been withholding their gas from interstate commerce (App. A, *infra*, pp. 2a-3a, n. 1). The suggestion is erroneous. The Commission's regulation does no more than codify, and make applicable to each certificate, an obligation that the Commission believes to be implicit in the Act. The regulation reflects the Commission's interpretation of the statute. The validity of an interpretative rule depends on its consistency with the statute, and not on any factual evidence or factual showing of a need for the rule. See *Abbott Laboratories* v. *Gardner*, 387 U.S. 136, 149; *Gardner* v. *Toilet Goods Association, Inc.*, 387 U.S. 167, 170-171; *Chisholm* v. *Federal Communications Commission*, 538 F. 2d 349, 366

3. Application of the prudent operator standard in particular cases will depend on the circumstances. A spectrum of cases can be posited. At one end is the producer who simply shuts down his well in the hope that higher gas prices will be obtained later, or the producer who deliberately fails to maintain his equipment properly and then claims he is unable to honor his obligation. At the other end may be cases in which production can be maintained only by drilling additional wells or by taking affirmative measures to maintain pressure in the reservoir. In determining what is "prudent," cases of the latter sort may require careful balancing of costs against the service obligation in the light of current regulatory price ceilings.[9]

The application of the prudent operator standard to particular cases, however, is not at issue here. What is at issue is the validity of the principle, appropriately promulgated in a rule, that the Commission has jurisdiction to prevent producers from evading their obligations under the Act by unreasonably failing to operate their facilities in a manner necessary to deliver the gas that they committed themselves to deliver when they obtained a certificate from the Commission. The court of appeals has entered a sweeping invalidation of this principle, on the ground that the production or gathering exclusion deprives the Commission of any authority to reach physical activities. The court has thus rejected not only the explicit provisions of the prudent operator regulation, but also the obligation, held by the Commission to be implicit in all producer certificates, that the holder maintain deliverability by operating prudently.

4. Because the court of appeals' judgment sets aside the Commission's order and regulation, there is no prospect of relitigating the validity of the prudent operator rule on a petition to review it in another circuit. Once the mandate of the court of appeals issues,[10] pending proceedings in other circuits will be mooted because issuance of the mandate will vacate the regulation.[11] Moreover, there is little prospect of testing the Commission's authority by an enforcement action under Section 20 of the Act, 15 U.S.C. 717s, alleging that a producer has violated the prudent operator standard implicit in his certificate. As

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(C.A.D.C.), certiorari denied, 429 U.S. 890. *Superior Oil Co.* v. *Federal Energy Regulatory Commission*, 563 F. 2d 191 (C.A. 5), and the other cases cited by the court of appeals (App. A, *infra*, pp. 2a-3a, n. 1) did not involve interpretative rules; see 563 F.2d 196, n. 9.

[9] See Policy With Respect to Rates Where Reduced Pressures, Need for Reconditioning, Deeper Drilling, or Other Factors Make Further Production Uneconomical at Existing Prices, 18 C.F.R. 2.76 (1977).

[10] The mandate has been stayed pursuant to Fed. R. App. P. 41(b).

[11] Other cases challenging the prudent operator condition have been held in abeyance pending the outcome of the petition for review in the instant case: *The Offshore Co.* v. *Federal Energy Regulatory Commission*, C.A. 5 No. 76-3756; *Continental Oil Co., et al.* v. *Federal Energy Regulatory Commission*, C.A. 5 No. 76-4508; *Cities Service Oil Co.* v. *Federal Energy Regulatory Commisison*, C.A. 5 No. 77-1363; *IGC Production Co.* v. *Federal Energy Regulatory Commision*, C.A. 9 No. 77-1148.

a practical matter, the most likely forum for such a case would be a district court in the Fifth Circuit, from which most of the nation's currently flowing gas comes.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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Federal Energy Regulatory Commission.

MAY 1978.

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 76-3066, Et Al.

SHELL OIL COMPANY ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT

Jan. 20, 1978

Before CLARK, RONEY and TJOFLAT, Circuit Judges:

TJOFLAT, Circuit Judge:

Shell Oil Company and other natural gas producers bring this petition to review the Federal Energy Regulatory Commission's (FERC) Order No. 539-B, —— F.P.C. ——, 41 Fed.Reg. 32,883 (1976), which established a regulation requiring a producer to act as a "prudent operator" in developing and

maintaining deliverability from natural gas reserves.[1]

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[1] Order No. 539-B, —— F.P.C. ——, 41 Fed.Reg. 32,883 (1976), establishes 18 C.F.R. § 157.41 (1977), which provides:

> On and after July [30], 1976, all certificates of public convenience and necessity for the sale of natural gas for resale in interstate commerce shall be conditioned as follows:
>
> All persons making jurisdictional sales pursuant to the authority granted by this certificate are hereby given notice that the contractual obligations between the buyer and the seller are incorporated into the certificate obligations, and that the certificate is further conditioned to require that the seller shall observe the standard of a prudent operator to develop and maintain deliverability from reserves dedicated hereunder.

Order No. 539-B is the third in a series of FERC orders, dealing with the development and maintenance of natural gas reserves. The first, Order No. 539, —— F.P.C. ——, 40 Fed. Reg. 49,571 (1975), was issued on October 14, 1975, without any notice, comment, or hearing as required for rule-making by the Administrative Procedure Act, 5 U.S.C. § 533 (1970). This Order stated the FERC's intention to enforce "delivery and supply obligations" purportedly contained in producer contracts and producer and pipeline certificates. The FERC's General Policy and Interpretations was amended by this Order by adding a new section, 18 C.F.R. § 2.83 (1975), delineating the FERC's policy on the enforcement of deliverability of natural gas services. On November 28, 1975, the Commission granted reconsideration of Order No. 539 on the application of a number of producers who asserted, among other grounds, that Order No. 539 misinterpreted both the producer-pipeline contractual arrangements and the existing certificate obligations. Issue was also taken with the institution of § 2.83 without following rule-making procedures. Administrative Procedure Act, 5 U.S.C. § 533 (1970). On March 26, 1976, the FERC issued a second order, Order No. 539-A, —— F.P.C. ——, 41 Fed.Reg. 14,531 (1976), to clarify its previous Order and properly to give notice of the intention of the Commission

to promulgate § 2.83 pursuant to a rule-making procedure. Finally, the FERC issued Order No. 539-B, withdrawing § 2.83 and instituting § 157.41, on July 30, 1976.

The impetus behind the FERC's actions was the charge made before various subcommittees of Congress that natural gas producers were avoiding the delivery obligations in their contracts of sale in order to realize greater profits. It was claimed that the producers were diverting natural gas from interstate to intrastate sales or withholding it in hope of future deregulation of the industry. No support for this charge appears in the record before us and the FERC stated in oral argument that its investigation has uncovered no evidence that the natural gas producers have been withholding supplies. We have held that when an FERC order

> originated in a policy decision of the agency and not as the outgrowth of factual determinations, the standard of review is whether the agency's action was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A) (1967). Under that standard we determine "whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment." *Superior Oil Co.* v. *FERC*, 563 F.2d 191, at 201 (5th Cir. 1977).

Section 7(e) of the Natural Gas Act requires the FERC to make findings that a proposed retroactive condition, such as the one imposed by Order No. 539-B, is reasonable and is required by the public convenience and necessity. *Pure Oil Co.* v. *FPC*, 292 F.2d 350, 352-53 (7th Cir. 1961); *see Atlantic Refining Co.* v. *Public Service Comm'n*, 360 U.S. 378, 394, 79 S.Ct. 1246, 1256, 3 L.Ed.2d 1312 (1959) (Harlan, J., concurring) and *Texaco, Inc.* v. *FPC*, 290 F.2d 149, 157 (5th Cir. 1961). In light of the FERC's admission that the natural gas producers were not withholding natural gas from interstate commerce, it is questionable whether Order No. 539-B can survive the limited review explicated in *Superior Oil Co.* We need not reach this question, however, since it will be shown *infra* that Order No. 539-B is beyond the FERC's jurisdiction.

The primary issue before us is whether this Order exceeds the Commission's jurisdiction to regulate the transportation and sale of natural gas in interstate commerce.

The FERC claims that the "prudent operator" obligation is an implied condition of the certificates of public convenience and necessity that are required under the Natural Gas Act before companies may transport or sell natural gas in interstate commerce. The Commission relies upon the concept expressed as "service" in the Natural Gas Act[2] to establish its

[2] Natural gas companies perform a service to the public, and the Commission's authority extends to ensuring that the service is properly performed even if it is not specifically manifested in a contractual relationship. *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 80 S.Ct. 1392, 4 L.Ed.2d 1623 (1960). This service is derived from the section of the Natural Gas Act empowering the FERC to issue certificates:

> . . . [a] certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require. 15 U.S.C. § 717f(e) (1970).

authority to hold certificate recipients to the "prudent operator" standard. No separate statutory or regulatory grant of jurisdiction has been cited by the FERC.

The producers, however, argue that the FERC is prohibited from issuing Order No. 539-B by the specific exclusion of "the production and gathering of natural gas" from the Commission's jurisdiction and that the FERC cannot use the power to issue certificates to extend its jurisdiction into the excluded area.[3] We agree with the producers and vacate the FERC's Order.

The jurisdiction of the FERC to regulate the natural gas industry is delineated by § 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b) (1970):

> The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

The producers are subject to the jurisdiction of the FERC when they engage in activities that can be

[3] Natural Gas Act § 1(b), 15 U.S.C. § 717(b) (1977). This was the position taken by Commissioner Watts in his dissent from Order No. 539-B.

classified as sales or transportation rather than as production or gathering. *Phillips Petroleum Co.* v. *State of Wisconsin*, 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035 (1954). Through the years, the "production or gathering of natural gas" exemption has been judicially narrowed. The progression can be seen by comparing *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 69 S.Ct. 1251, 93 L.Ed. 1499 (1949) with *United Gas Improvement Co.* v. *Continental Oil Co.* (*Rayne Field*), 381 U.S. 392, 85 S.Ct. 1517, 14 L.Ed.2d 466 (1965). The *Panhandle* case held that gas leases relate to the production or gathering of natural gas and are thus outside the jurisdiction of the FERC. The Supreme Court narrowly construed *Panhandle* in *Rayne Field* when it held that leases that are in essence sales of the gas reserves are within the FERC's jurisdiction. In *Rayne Field* the producers recast a conventional wellhead purchase of natural gas as a purchase of the leasehold interests in the natural gas field. The Supreme Court described this sale of leasehold interests as "very close in economic effect to [traditional] sales of natural gas," *id.*, 85 S.Ct. at 1520, and stated that:

> *The "production or gathering" exemption relates to the physical activities, processes and facilities of production or gathering*, but not to sales of the kind affirmatively subjected to Commission jurisdiction. This accommodation of the two relevant clauses of § 1(b) gives content to the national objectives of the Natural Gas Act as expanded in Phillips, and to the Commission's jurisdiction to accomplish them, while in no way

> interfering with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate state concerns. *Id.* 381 U.S. at 403, 85 S.Ct. at 1523. (Emphasis added.)

The FERC can enforce "service obligations" contained in the certificates that it issues to producers, preventing producers from ceasing deliveries from fields admittedly capable of continuing production. This doctrine was developed in *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 80 S.Ct. 1392, 4 L.Ed. 2d 1623 (1960) and *Sun Oil Co.* v. *FPC*, 364 U.S. 170, 80 S.Ct. 1388, 4 L.Ed.2d 1639 (1960), based on the power to issue certificates, see note 2 *supra*, and prevents producers from beginning delivery to another party after the initial contracts expire. Another line of cases permits the FERC to regulate the "abandonment of service." *Mitchell Energy Corp.* v. *FPC*, 533 F.2d 258 (5th Cir. 1976); *Panhandle Eastern Pipe Line Co.* v. *Michigan Consolidated Gas Co.*, 177 F.2d 942 (6th Cir. 1949).

No case has been found, however, that extends FERC jurisdiction directly into the physical activities, processes, and facilities of production and development. The cases recognizing the broad scope of the FERC's authority have nonetheless also recognized the "production or gathering" exclusion. In *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581, 65 S.Ct. 829, 89 L.Ed. 1206 (1945), after holding that the FERC could include production properties in the rate base of an interstate pipeline company, the Supreme Court stated:

> that does not mean that the part of § 1(b) which provides that the Act shall not apply "to the production or gathering of natural gas" is given no meaning. Certainly that provision precludes the Commission from any control over the activity of producing or gathering natural gas. For example, it makes plain that the Commission has no control over the drilling and spacing of wells and the like. *Id.* at 602-03, 65 S.Ct. at 839.

In *Continental Casualty Co.* v. *Associated Pipe & Supply Co.*, 447 F.2d 1041, 1052 (5th Cir. 1971), we echoed Mr. Justice Blacks' definition of "the production or gathering of natural gas:"

> "Production" of gas [means] the act of bringing gas from the earth, and "gathering" [means] the act of collecting gas after it has been brought forth. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 518, 69 S.Ct. at 1262 (Black, J., dissenting).

See also Northern Natural Gas Co. v. *State Corporation Comm'n*, 372 U.S. 84, 90, 83 S.Ct. 646, 650, 9 L.Ed.2d 601 (1963) (" 'production' and 'gathering' are terms narrowly confined to the physical acts of drawing the gas from the earth and preparing it for the first stages of distribution.")

Order No. 539-B clearly is intended to open the door to FERC involvement into forbidden production activities:[4]

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[4] During oral argument, the FERC's counsel first stated that the FPC could require producers to drill new wells pursuant to Order No. 539-B; counsel later withdrew from this position and stated that the Commission could not do so because such a requirement would be beyond its power. The Commission staff, however, has not adopted a restrictive view of the authority granted to the FERC under Order 539-B. In its initial brief to the FERC in Docket No. R175-112 (Dec. 6, 1976), the Staff stated:

> Immediate development of these known proved reserves will serve the public interest by increasing the supply of natural gas available to the interstate market. In the event that such development is not undertaken voluntarily by the producers, *staff recommends that the Commission use its authority pursuant to Order 539-B to insure full and timely development of these dedicated proved reserves.*
>
> An answer to the question of whether *production from "behind the pipe" reserves should be accelerated by drilling new wells* involves a policy determination based on a careful consideration of a number of factors . . . *Id.* at 213. (Emphasis added.)

> This [prudent operator] standard encompasses the obligations to develop the properties consistent with the performance requirements of lease agreements with mineral owners and/or assignors; all valid rules and regulations of any Federal, state or local government having jurisdiction; and the *standard of what a reasonably prudent producer would do with respect to the drilling completion, workover, recompletion or abandonment of wells.* —— F.P.C. at ——, 41 Fed.Reg. at 32,884. (Emphasis added.) (Footnote omitted.)

To hold that the power to issue Order No. 539-B is within the jurisdiction of the FERC would all but eliminate the "production or gathering" exclusion and would allow the FERC to encroach on areas reserved to the states.[5] We cannot so extend the au-

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[5] The Supreme Court has discussed extensively the legislative history of the Natural Gas Act in *Phillips Petroleum*

thority of the Commission.[6]

VACATED AND REMANDED.

Co. v. *Wisconsin*, 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035 (1954) and *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 69 S.Ct. 1251, 93 L.Ed. 1499 (1949). *See also Panhandle Eastern Pipe Line Co.* v. *Public Service Comm'n of Indiana*, 332 U.S. 507, 514-21, 68 S.Ct. 190, 193-97, 92 L.Ed. 128 (1947); *Interstate Natural Gas Co.* v. *FPC*, 331 U.S. 682, 689-90, 67 S.Ct. 1482, 1486-87, 91 L.Ed. 1742 (1947); *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581, 601-03, 65 S.Ct. 829, 838-39, 89 L.Ed. 1206 (1945); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 609-13, 64 S.Ct. 281, 291-92, 88 L.Ed. 333 (1944); *Illinois Natural Gas Co.* v. *Central Illinois Public Service Co.*, 314 U.S. 498, 506-08, 62 S.Ct. 384, 397-98, 86 L.Ed. 371 (1942). It is clear that the Natural Gas Act was passed to fill the gap in regulation of the natural gas industry created by judicial holdings precluding state regulation of interstate commerce:

> The Natural Gas Act was designed to supplement state power and to produce a harmonious and comprehensive regulation of the industry. Neither state nor federal regulatory body was to encroach upon the jurisdiction of the other. Congress enacted this Act after full consideration of the problems of production and distribution. It considered the state interests as well as national interests. *Panhandle Eastern Pipe Line Co.*, 337 U.S. at 513, 69 S.Ct. at 1260. (Footnotes omitted.)

[6] One final question raised concerns the "prudent operator" standard promulgated by Order No. 539-B. The argument is advanced that the "prudent operator" standard is inappropriate to FERC's goal to increase production of natural gas because "prudent operator" is a term of art employed in state regulations which are concerned with increasing the total recovery of hydrocarbons through the *conservation* of natural gas fields rather than permitting operators to waste energy resources by *exploitation* of reserves. We do not reach the issue due to our disposition on jurisdictional grounds.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1977

No. 76-3066, et al.

FPC No. RM 76-8

SHELL OIL COMPANY, ET AL., PETITIONERS,

versus

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

Petitions for Review of an Order of the
Federal Power Commission

Before CLARK, RONEY and TJOFLAT, Circuit Judges.

JUDGMENT

This cause came on to be heard on the petitions of Shell Oil Company, et al. for review of an order of

the Federal Power Commission, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the order of the Federal Power Commission in this cause be, and the same is hereby vacated; and that this cause be, and the same is hereby remanded to the Federal Power Commission in accordance with the opinion of this Court;

It is further ordered that intervenor-respondent, Consumer Federation of America, pay to intervenors-petitioners, the costs on appeal to be taxed by the Clerk of this Court.

January 20, 1978

APPENDIX C

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Richard L. Dunham, Chairman; Don S. Smith, John H. Holloman III, and James G. Watt.

Docket No. RM76-8

POLICY WITH RESPECT TO ENFORCEMENT OF DELIVERABILITY AND RENDITION OF NATURAL GAS SERVICE UNDER CERTIFICATED ARRANGEMENTS

ORDER NO. 539-B

ORDER CLARIFYING PRIOR ORDERS AND AMENDING SECTION 157 OF THE COMMISSION'S REGULATIONS UNDER THE NATURAL GAS ACT

(Issued July 30, 1976)

In Order No. 539 [1] the Commission reiterated its policy to enforce certificated delivery obligations. In Order No. 539-A [2] the Commission clarified its prior

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[1] Promulgating Statement of Policy, Order No. 539, Docket No. RM76-8, —— FPC —— (October 14, 1975).

[2] Order Granting In Part And Denying In Part Reconsideration, Clarifying Order No. 539, Denying Stay, Noticing Of Proposed Rulemaking, Noticing Of Oral Argument And Granting Intervention, Order No. 539-A, —— FPC —— (March 26, 1976).

order, granted in part and denied in part reconsideration, and issued a notice of proposed rulemaking to promulgate Section 2.83 as a section of the Commission's General Policy and Interpretations. Written comments on the proposed rulemaking were received and oral argument before the Commission was held on May 4, 1976. The entire record in Docket No. RM76-8 is now before us for final determination.

In Order No. 539, we spoke of a "certificated minimum daily delivery obligation". From the reactions of the parties, we learned that the quoted phrase meant different things to different persons, depending, of course, on their respective views of the certainty of natural gas production. Some respondents interpreted the phrase to mean that a producer would be required to deliver a set volume of gas every day for the entire contract term or be subject to the criminal penalties of the Natural Gas Act,[3] while other persons related the meaning of the phrase to the producer's best efforts to deliver presently producible supplies. Our attempt in Order No. 539-A to clarify the meaning of "certificated minimum daily delivery obligation" did not settle the matter, as the continued confusion in the rulemaking proceeding showed. We must conclude that the clause is not one that has a generally accepted meaning among pipelines and producers. In this order, based on all material submitted in Docket No. RM76-8, we will make clear the intention of the Commission with respect to

[3] Natural Gas Act, § 21; 15 U.S.C. § 717t.

its policy on certificate obligations and enforcement of such obligations.

Under Section 7 of the Natural Gas Act,[4] the Commission authorizes a natural gas company to perform a service, the sale for resale in interstate commerce of natural gas. In order for this sale by a producer to be lawful, it must procure from the Commission a certificate of public convenience and necessity. This certificate is the physical evidence of the producer's right to commence the approved service.[5] The certificate itself sets forth the terms and conditions under which the producer must operate, which include but are not limited to those obligations incurred by reason of the contract of sale.

Whatever the obligations voluntarily entered into by the producer in the contract of sale with the pipeline, the contract terms must normally bow to the conditions included in the certificate. Where, however, the contract provisions incorporated into the certificate include greater responsibilities and obligations than those imposed by the certificates, such as in a warranty of delivery agreement, the producer, of course, will be held accountable to those greater responsibilities and obligations.

Some parties to this proceeding advance the argument that a common term in producer-pipeline contracts called the "sole discretion" clause permits the

[4] Natural Gas Act, § 7; 15 U.S.C. §§ 717f(a)-(e).

[5] *Atlantic Refining Co.* v. *Public Service Commission of N.Y.*, 360 U.S. 378, 389 (1959).

producer complete control over deliverability to the pipeline. Thus, a typical reservations clause in a sales contract provides, in part, that the seller reserves the right "to operate its property free from any control by Buyer in such manner as Seller, in its *sole discretion* may deem advisable, including without limitation, the right to drill new wells, to repair and rework wells and to abandon any well. . ." [6] (Emphasis added.) Even though the view that the seller rules the transaction is not universally held even in the industry,[7] the Commission wants to make clear that its certificate conditions, and the incidents of service which it represents, are superior to any limitations on Commission authority contained in the contract.

The question then, which the Commission attempted to address in Order Nos. 539 and 539-A, is what standard or test of deliverability the producer is required to live up to under the provisions of the Natural Gas Act and the rules and regulations of this Commission. Natural gas companies,[8] as that term is defined in the Natural Gas Act [9] are required

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[6] See, *e.g.*, Comments of Tenneco Oil Company, Docket No. RM76-8, Appendix A, p. 7, filed April 19, 1976.

[7] Oral Argument, Tr. 95-96.

[8] The Supreme Court's decision in *Phillips Petroleum Company* v. *Wisconsin*, 347 U.S. 672 (1974) found independent producers to be "natural gas companies" within the meaning of Section 2(6) of the Natural Gas Act, 15 U.S.C. 717a(6).

[9] 15 U.S.C. § 717a.

under Sections 4, 5, and 7 [10] to fulfill certain service obligations arising from the Act itself,[11] together with other responsibilities that may result from other Federal or State laws or the law of private contracts. Pursuant to the Act itself, however, jurisdictional sales, service, and operation of natural gas companies must be just, reasonable, not unduly discriminatory, preferential, or otherwise unlawful, and in the public interest.

In response to the allegations that have been made concerning our authority to enforce certificate obligations and to condition certificates to aid in this enforcement, Section 7(e) of the Natural Gas Act [12] provides that, in order for the Commission to issue a certificate of public convenience and necessity, it must determine that the applicant is ". . . able and willing *properly* to . . . perform the service proposed . . ." (emphasis added). Certain parties to this proceeding have asserted that this finding is made only at the commencement of the sale. Such a contention does not comport with the ordinary meaning of "service", which implies a continuing obligation, nor with the remainder of the section, which requires that the applicant be found to be willing to conform to the provisions of the Natural Gas Act and the Commis-

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[10] 15 U.S.C. §§ 717c, 717d, 717f.

[11] *F.P.C.* v. *Louisiana Power and Light Company*, 406 U.S. 621 (1972); *Pennsylvania Water and Power Company* v. *F.P.C.*, 343 U.S. 414, 422 (1952).

[12] 15 U.S.C. § 717f(c).

sion's Regulations.[13] The Commission has long recognized a distinction between the service to the public that is certificated and the contractual agreement that provides for the sale, especially since the service obligation outlives the contractual authorization.[14] Since the requirement of service continues until the Commission permits abandonment, and since the holder of a certificate from the Commission must comply with the rules and regulations thereof, it is simply incorrect to assert that the Commission cannot act to preserve the integrity of its certification process by conducting an oversight review of an on-going service obligation.[15] A mere reference to the authority granted the Commission in Section 5(a) of the Act[16] should suffice to prove the correctness of the view that the Commission has a continuing responsibility to the public to insure that recipients of certificates issued by the Commission are, throughout the life of the certificate, performing consistent with their obligations under the Natural Gas Act.

Historically, jurisdictional actions of natural gas companies have been reviewed by this Commission on the basis, among others, of whether the company

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[13] *Mitchell Energy Co.* v. *F.P.C.*, —— F.2d ——, No. 75-3110 (5th Cir., June 11, 1976).

[14] *Sunray Mid-Continent Oil Co.* v. *F.P.C.*, 364 U.S. 137 (1960) at 152-153.

[15] *United Gas Pipe Line Co.* v. *F.P.C.*, 385 U.S. 83, 89 (1966).

[16] 5 U.S.C. § 717d.

acted prudently under the circumstances presented.[17] The prudent operator standard has long been established as an implied covenant in lease agreements, which means that producers are very familiar with the requirements of this standard.[18] Furthermore, state regulatory agencies, whose principal purpose is conservation of natural resources, require producers to conform to their codified regulations, which are consistent with the responsibilities imposed by the prudent operator standard.[19] The Department of the Interior has, in effect, incorporated the prudent operator test into its offshore regulations by the use of the terms "reasonable" and "diligence" in describing the lessee's obligations as set forth in the leasing agreement.[20] Obviously, then, all producers are acquainted with the strictures of the prudent operator standard. Therefore, there should be no contention that the Commission's action in the instant order is insufficiently specific for respondents to understand the responsibilities incurred in complying with the prudent operator standard.[21]

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[17] *F.P.C.* v. *Natural Gas Pipeline Company*, 315 U.S. 575 (1942).

[18] *See*, Williams, Howard R. and Meyers, Charles J., *Oil and Gas Law*, § 806, Prudent-Operator Standard, Volume 5, Matthew Bender & Company, Inc. (1972). *See also*, Oral Argument of May 4, 1976, in Docket No. RM76-8, Tr. 6-7, 62-64, 95-96, 122; *Gas and Oil*, § 127 Generally; prudent operator rule, 38 Am. Jur.2d 601 (1968).

[19] Oral Argument, Tr. 15.

[20] 30 C.F.R. § 250.33, 43 C.F.R. §§ 3307.3-2, 3307.3-4.

[21] Our clarification herein should not be interpreted as relieving pipelines from their obligations, arising under the

Once deliveries have commenced under the certificate, as conditioned, the responsibility for the development and maintenance of the gas reserves underlying the committed acreage rests with the producer, and the applicable standard by which to judge whether a producer is properly proceeding with these responsibilities will be the above-referenced "prudent operator standard".

This standard encompasses the obligations to develop the properties consistent with the performance requirements of lease agreements with mineral owners and/or assignors; all valid rules and regulations of any Federal,[22] state or local government having jurisdiction; and the standard of what a reasonably prudent producer would do with respect to the drilling completion, workover, recompletion or abandonment of wells.

We have set forth in this order the nature and extent of the service obligations incurred by a natural gas company in accepting a certificate from this Commission, along with tracing the historical link between service and prudent operation. Therefore, it is consistent with the expression in Order Nos. 539 and 539-A of a statement of policy, that the Commission reiterates its intention to enforce the prudent operator standard as implicit in the service obligations contained in all existing certificates.

Natural Gas Act, to enforce certificated contractual obligations unilaterally where the need arises.

[22] Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331, *et seq. See also,* 30 C.F.R. §§ 250, *et seq.*; 43 C.F.R. §§ 3300, *et seq.; OCS Orders 1 through 12, Governing Oil, Gas, And Sulphur Leases To The Outer Continental Shelf Gulf Of Mexico Area,* United States Department of the Interior, Geological Survey, Conservation Division, January, 1975.

The Commission's authority to hold certificate recipients to the prudent operator standard rests, as we have previously stated, in the concept expressed in the Natural Gas Act as service, as that term has been interpreted by the Commission and the courts. For example, the Supreme Court in *Sunray Mid-Continent Oil Company* v. *Federal Power Commission* [23] stated:

> [t]he Commission's practice supports its authority here in the terms of § 7(e). It has long drawn a distinction between the underlying service to the public a natural gas company performs and the specific manifestation—the contractual relationship—which that service takes at a given moment.[24]

The Commission has embodied this idea into its certificates of public convenience and necessity by including as a condition thereof the following language:

> The grant of the certificates issued in paragraph (A) above shall not be construed as a waiver of the requirements of Section 7 of the Natural Gas Act or of Part 154 or Part 157 of the Commission's Regulations thereunder and is without prejudice to any findings or orders which have been or which may hereafter be made by the Commission in any proceedings now pending

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[23] 364 U.S. 137 (1960).

[24] *Id.* at 152.

or here instituted by or against Applicants. Further, our action in this proceeding shall not foreclose or prejudice any future proceedings or objections relating to the operation of any price or related provisions in the gas purchase contracts herein involved. The grant of the certificates aforesaid for service to the particular customers involved does not imply approval of all of the terms of the contracts, particularly as to the cessation of the service upon termination of said contracts as provided by Section 7(b) of the Natural Gas Act. The grant of the certificates aforesaid shall not be construed to preclude the imposition of any sanctions pursuant to the provisions of the Natural Gas Act for the unauthorized commencement of any sales of natural gas subject to said certificates.[25]

The Commission has only recently spoken to the issue presented in this rulemaking procedure, the relationship of the contract to the certificate and which prevails if there is a conflict. In its Opinion No. 662 the Commission held that:

> [t]he contract between Texas Eastern and Gulf obviously gave rise to rights and obligations; much is made in the briefs before us concerning the nature, extent and enforceability of those rights and obligations. We set these matters aside. We look instead to Gulf's certificate of public convenience and necessity, for it too gave rights and obligations, and these are clearly ours

[25] *See, e.g.*, Amoco Production Company, et al., Docket No. CI63-479, *et al.*, issued September 19, 1975.

> to interpret, modify, or enforce as the case may require. (Footnote omitted.)[26]

As an additional objection to a Commission imposed standard of deliverability, the producers have strenuously argued that Section 1(b) of the Natural Gas Act prohibits the Commission from conditioning, pursuant to Section 7(e) of the Act, a certificate to aid in the enforcement of delivery obligations that exist in a contract as certificated. Section 1(b) does not, however, preclude the Commission from enforcing the contractual provisions of a gas sales contract and various delivery obligations contained therein or in the certificate. As the Court indicated in *Phillips Petroleum Company* v. *Wisconsin*,[27] "sales in interstate commerce for resale by producers to interstate pipeline companies do not come within the 'production or gathering' exemption." Once a contract has been certificated, the obligations must be performed in accordance with the provisions of the Natural Gas Act, including Section 7(b) of the Act. If the seller under a certificate is not meeting the delivery obligations of such certificate, there has been either a partial or total abandonment of certificated service which requires Commission approval pursuant to Section 7(b). Accordingly, attachment of a condition to a certificate to assure compliance with Section 7(b) of the Act cannot be considered an unreasonable condi-

[26] *Gulf Oil Corporation*, Docket No. CI64-26, 51 FPC 1340, 1352 (1974).

[27] 347 U.S. 672, 680-81 (1954).

tion contrary to the requirements of Section 7(e) of the Act. Moreover, Section 1(b) of the Act does not, in any fashion, limit the Commission's authority conferred upon it by Section 7(b).

Despite the Commission's belief that the prudent operator standard is implicit in the service obligation included in all certificates issued by this Commission, we wish to make this point clear to all future certificate applicants by including as a condition in all certificates issued on or after the date of this order notice of the supremacy of the certificate to the contract and the application of the prudent operator standard to deliverability obligations. Therefore, pursuant to the notice of proposed rulemaking set forth in Order No. 539-A, the Commission will amend its Rules and Regulations to add a new Section 157.41, to read as follows:

> On and after July 30, 1976, all certificates of public convenience and necessity for the sale of natural gas for resale in interstate commerce shall be conditioned as follows:
>
> All persons making jurisdictional sales pursuant to the authority granted by this certificate are hereby given notice that the contractual obligations between the buyer and the seller are incorporated into the certificate obligations, and that the certificate is further conditioned to require that the seller shall observe the standard of a prudent operator to develop and maintain deliverability from reserves dedicated hereunder.

A party that objects to the inclusion of this condition in its certificate may reject the certificate outright

or accept with the reservation of its right to appeal the offending condition under Section 19(b).[28]

In light of our clarification of Order Nos. 539 and 539-A holding a producer to the legally applicable principle of the prudent operator standard, Section 2.83 of the Commission's Regulations is hereby deleted from the Commission's General Policy and Interpretations. As to all certificates issued from October 14, 1975 to date that contain Section 2.83(d) as a condition thereof, whether accepted and/or whether rehearing or reconsideration of the order issuing said certificate was sought or not, the Section 2.83(d) condition contained therein is hereby vacated, but each and every other condition included in said certificate is fully applicable, unless such condition has become the subject of a petition for rehearing or reconsideration that has been granted by this Commission.

In lieu of the Section 2.83(d) condition included in all certificates issued on or after the October 14, 1975 date of Order No. 539, the Commission will substitute therefore the prudent operator standard presented herein and incorporated into the Commission's Regulations as new Section 157.41. This provision applies whether rehearing or reconsideration was sought, whether granted as yet or not, those proceedings are incorporated into this rulemaking proceeding for resolution. Because of the Commission's decision expressed in this order to use the prudent operator

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[28] 15 U.S.C. § 717r.

test to judge the service obligation of the producer under the certificate, all petitions for rehearing or reconsideration pending before this Commission are granted in part and denied in part.

Finally, the data necessary to facilitate any Commission action deemed necessary in implementing the instant order is either currently required to be filed by the appropriate persons or will be required as a result of our order implementing Form No. 108. More specifically, any information and materials submitted by virtue of Form No. 108, Form No. 15 and Form No. 40 will be used to assist the Commission and its Staff in enforcing certificated obligations.

The Commission finds:

(1) The Commission's prior orders, Order Nos. 539 and 539-A, should be clarified consistent with this order.

(2) The notice and opportunity to participate in this proceeding with respect to the matter presently before the Commission through the submission, in writing of comments and through participation at oral argument before the Commission, is consistent and in accordance with all procedural requirements therefore as prescribed in Section 553, Title 5 of the United States Code.

(3) The amendment to Section 157 of the Commission's Regulations Under the Natural Gas Act is necessary and appropriate for the administration of the Natural Gas Act.

(4) Section 2.83 should be deleted from Part 2, Statements of General Policy and Interpretations of the Commission.

(5) The Commission should include in all certificates issued on or after the date of issuance of this order a condition stating that all sales made pursuant to the certificate are subject to review under the prudent operator standard.

(6) It is in the public interest to delete Section 2.83 (d) as a condition to all certificates issued on or after October 14, 1975, whether such certificates were accepted or not, and insert in its place the condition set forth in the newly promulgated Section 157.41 of the Commission's Regulations under the Natural Gas Act.

(7) It is in the public interest that all petitions for rehearing or reconsideration raising an issue regarding the imposition of Section 2.83(d) as a condition to a certificate are incorporated into this proceeding for disposition of that issue and should be granted in part and denied in part for the reasons expressed in this order.

The Commission orders:

(A) The Commission's Order Nos. 539 and 539-A are clarified consistent with this Order.

(B) The Commission, acting pursuant to its authority under the Natural Gas Act, as amended, particularly Sections 4, 5, 7, and 16 thereof, 15 U.S.C. 717c, 717d, 717f, and 717o, hereby orders that its General Rules, Title 18 of the Code of Federal

Regulations, be amended by adding a new Section 157.41 as follows:

> On and after July —, 1976, all certificates of public convenience and necessity for the sale of natural gas for resale in interstate commerce shall be conditioned as follows:
>
> All persons making jurisdictional sales pursuant to the authority granted by this certificate are hereby given notice that the contractual obligations between the buyer and the seller are incorporated into the certificate obligations, and that the certificate is further conditioned to require that the seller shall observe the standard of a prudent operator to develop and maintain deliverability from reserves dedicated hereunder.

(C) Section 2.83 is deleted from Part 2 Statements of General Policy and Interpretations of the Commission.

(D) The Section 2.83(d) condition attached to all certificates issued on or after October 14, 1975, is deleted from such certificates and the condition contained in Section 157.41 of the Commission's Regulations under the Natural Gas Act is inserted in its place.

(E) All petitions for rehearing or reconsideration raising an issue regarding the imposition of Section 2.83(d) or as a condition to a certificate of public convenience and necessity are incorporated into this proceeding for disposition of that issue and are granted in part and denied in part for the reasons expressed in this order.

By the Commission. Commissioner Watt, dissenting, filed a separate statement appended hereto.

[SEAL]

KENNETH F. PLUMB,
Secretary.

WATT, Commissioner, *dissenting*:

I have worked hard with my fellow Commissioners in an effort to resolve our differences in this case. Unfortunately, there is one major issue we have not been able to agree upon. Therefore I must dissent.

Order No. 539 from its inception has been a nightmare for the Federal Power Commission. That Order states, "The Commission has concluded that it should formally reiterate its policy with respect to the enforcement of the requirements of the Natural Gas Act . . ." because ". . . Questions concerning deliverability and supply obligations of natural gas producers and natural gas pipelines have arisen in connection with numerous Congressional hearings involving the Natural Gas Act." The Order proceeds then to outline what at the time was thought by a few to be the Federal Power Commission policy.

The Order has brought confusion and misunderstandings because many have interpreted it to be an unauthorized extension of jurisdiction not conferred by the Natural Gas Act. As a result of that October 1975 Order, access to over 18 Bcf of natural gas is being denied to the interstate market. In addition, there could well be a substantial quantity of natural gas that has not been considered for introduction into the interstate market because of fears created by the illegal extensions of authorities assumed by the Federal Power Commission.

Once the Commission paused to look at what had been done in the original Order, Order No. 539-A was

issued in an attempt to clarify and straighten out the errors. In my opinion, the rewriting of the policy statement in Order No. 539-A was correctly and properly done. But unfortunately, the majority insisted upon maintaining the § 2.83(d) condition in all certificates. The majority now has recognized that error and in Order 539-B has withdrawn and expunged from all those certificates the ill-conceived language. (I have consistently dissented to the inclusion of the § 2.83(d) language in all certificates.)

Now the majority in an attempt to again clarify and straighten out the problems that continue to multiply, has issued a new Order that in my judgment is, also, in error. It creates a substitute condition (Section 157.41) for all certificates that dictates action which is beyond FPC authority.

In my opinion, the Federal Power Commission authority, conferred by the Natural Gas Act with respect to producers, is limited virtually to rate regulation.[1] The Federal Power Commission does not have the authority to require the development of gas reserves dedicated to the interstate market. That authority rests in the lessor or appropriate governmental agency specifically granted such authority by enabling legislation.

A possible result of today's Order is that additional gas will be lost to the interstate market while pro-

---

[1] See e.g. *Interstate Natural Gas Co.* v. *F.P.C.*; 331 U.S. 682, 690, 691 (1946) and *Colorado Interstate Gas Co.* v. *F.P.C.*; 324 U.S. 581, 597-604 (1946).

ducers seek judicial remedy of the errors of the Federal Power Commission. It is unfortunate that the Commission continues to insist upon asserting jurisdiction over activities over which it has no authority.

/s/ James G. Watt
Commissioner

APPENDIX D

Section 1(b) of the Natural Gas Act, 52 Stat. 821, 15 U.S.C. 717(b) provides:

> (b) Transactions to which provisions of chapter applicable
>
> The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

Section 7(b) of the Natural Gas Act, 52 Stat. 824, 15 U.S.C. 717f(b) provides:

> (b) Abandonment of facilities or services; approval of Commission
>
> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

Section 7(c) of the Natural Gas Act, as added, 56 Stat. 83, 15 U.S.C. 717f(c) provides in pertinent part:

> (c) Certificate of public convenience and necessity
>
> No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: * * *
>
> * * * *

Section 7(e) of the Natural Gas Act, as added, 56 Stat. 84, 15 U.S.C. 717f(e) provides:

> (e) Granting of certificate of public convenience and necessity
>
> Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter and the requirements, rules, and regulations of the Commission thereunder, and

> that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

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Supreme Court, U. S.
FILED
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MICHAEL RODAK, JR., CLERK

APPENDIX

In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 77-1652

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

—v.—

SHELL OIL COMPANY, *et al.*,
Respondents.

No. 77-1654

CONSUMER FEDERATION OF AMERICA,
ENERGY POLICY TASK FORCE,
Petitioner,

—v.—

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITIONS FOR A WRIT OF CERTIORARI FILED MAY 19 AND 20, 1978

CERTIORARI GRANTED OCTOBER 2, 1978

In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 77-1652

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

—v.—

SHELL OIL COMPANY, *et al.*,
Respondents.

No. 77-1654

CONSUMER FEDERATION OF AMERICA,
ENERGY POLICY TASK FORCE,
Petitioner,

—v.—

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

(Title omitted in printing)

RELEVANT DOCKET ENTRIES

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UNITED STATES OF AMERICA

FEDERAL POWER COMMISSION

(18 CFR 2.83)

Natural Gas Company — (Certificate)

Before Commissioners: John N. Nassikas, Chairman; Don S. Smith, and John H. Holloman, III.

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Services Under Certificated Arrangements	))))	Docket No. RM76-8

ORDER NO. 539

PROMULGATING STATEMENT OF POLICY

(Issued October 14, 1975)

The Commission has concluded that it should formally reiterate its policies with respect to the enforcement of requirements of the Natural Gas Act, 15 U.S.C. 717(a) *et seq.*, as they relate to deliverability and the rendition of natural gas service under certificated arrangements pursuant to that Act.

Events relative to natural gas supplies and demands for natural gas service currently, and over recent past periods, warrant our doing so at this time. Questions concerning deliverability and supply obligations of natural gas producers and natural gas pipelines have arisen in

connection with numerous Congressional hearings involving the Natural Gas Act[1], as well as in the day-to-

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day administration of the provisions of the Natural Gas Act by this agency.

It is the policy of this Commission to enforce all delivery and supply obligations of jurisdictional natural gas producers and jurisdictional natural gas pipelines, as they may be occasioned by applicable regulations of the Commission and the statutory standards of the Natural Gas Act, which govern — and, therefore, which are incorporated within — the certificates for all certificated arrangements authorized pursuant to the Act. In addition to these standards, there are numerous delivery and supply obligations arising from contractual obligations extant among natural gas producers, pipelines or distributors.

1. See, for example: Preliminary Staff Report of the Subcommittee on Oversight and Investigations, House Committee on Interstate and Foreign Commerce, 94th Congress, 1st Session, July 18, 1975; Hearings on Natural Gas Supplies Before the Subcommittee on Oversight and Investigations, House Committee on Interstate and Foreign Commerce, 94th Congress, 1st Session, June 9, 13, 26 and 27, July 14 and 21, 1975, Serial Nos. 94-23 and 94-24; Federal Preparedness to Deal With the Natural Gas Shortage Emergency This Coming Winter: Third Report by the House Committee on Government Operations, 94th Congress, 1st Session, July 25, 1975, pp. 24 and 35; Federal Preparedness to Deal With the United States Natural Gas Shortage; Hearings Before the Subcommittee on Conservation, Energy and Natural Resources, House Committee on Government Operations, 94th Congress, 1st Session, June 12 and 26, 1975; Federal Power Commission Oversight Hearings, Committee on Commerce, United States Senate, 93d Congress, 2nd Session, August 20 and 22, 1974, Part 2, pp. 331-336; and Hearings on Natural Gas and Oil Regulatory Bills Before the Committee on Commerce, United States Senate, October 10, 11 and 24, 1973, Part I, pp. 209-211.

It is the policy of the Commission that each affected producer, pipeline or distributor shall take all appropriate actions to enforce those obligations, in the appropriate administrative or judicial forum at Federal, state or local levels. The constraints of private contracts operate in conjunction with and subject to public regulatory power.

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We believe our action will be helpful to provide certainty of legal obligations and regulatory enforcement policy, and to provide reliable gas service to the natural gas industry, natural gas consumers, Federal, state and local governmental authorities and members of the general public which may be concerned with the adequacy and reliability of natural gas supplies and services throughout the Nation.

The Natural Gas Act — Legal authority for the rendition of a jurisdictional sale or service of natural gas in interstate commerce under the Natural Gas Act, 15 U.S.C. 717, is evidenced by appropriately issued certificates of this Commission pursuant to Section 7 of that Act, 15 U.S.C. 717f, and appropriately effective rate schedules pursuant to Sections 4 and 5 of that Act, 15 U.S.C. 717c and d. Without Commission authorization "no natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission * * * unless there is in force with respect to such natural gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations * * *.", 15 U.S.C. 717f(c). Abandonment of jurisdictional facilities or services is prohibited

Contractual Arrangements—Contractual relations between jurisdictional suppliers of natural gas, jurisdictional pipeline or non-jurisdictional distributors of natural gas are circumscribed by, and are themselves subject to, the statutory standards of the Natural Gas Act. As the Supreme Court stated in *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 153, 155-6 (1960):

> * * * The Power Commission has from an early date taken the view that there is a continuing obligation to perform "service" imposed by the Act which outlasts the terms of a seller's original contract of sale (at p. 153).

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* * * *Mobile* recognized that there were two sources of price and supply stability inherent in the regulatory system established by the Natural Gas Act—the provisions of private contracts and the public regulatory power * * * An initial application of an independent producer, to make movements of natural gas in interstate commerce, leads to a certificate of public convenience and necessity under which the Commission controls the basis on which "gas may be initially dedicated to interstate use. Moreover, once so dedicated there can be no withdrawal of that supply from continued interstate movement without Commission approval. The gas operator, although to this extent a captive subject to the jurisdiction of the Commission, is not without remedy to protect himself." 360 U.S., at 389. That remedy he has, as the Court there said, in the "change" power under § 4 (d) when his contract

unless the Commission has found "* * * that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment." 15 U.S.C. 717f(b).

Among the conditions of every Section 7 certification are the requirements of subsection 7(e) that the applicant is able and willing properly *inter alia:*

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—to do the acts and to perform the service proposed;

—to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission; and

—that the proposed service, sale, operation, construction, extension or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity.

Sections 4 and 5 of the Natural Gas Act obligate each natural gas company to render jurisdictional sales or services which are just and reasonable and without undue discrimination or preference: all in accordance with rates, charges, classifications, rules, regulations, practices or contracts which are just, reasonable and not unduly discriminatory or preferential. See *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621 (1972), and cases therein cited; and *Pennsylvania Power Co. v. FPC*, 343 U.S. 414 (1952), interpreting the comparable rate and service provisions of the Federal Power Act, 16 U.S.C. 824d and e.

has expired or where his contract permits its use during its term. Under a similar Act, this Court has held to the same effect as we hold today. *Pennsylvania Water & Power Co.* v. *Federal Power Comm'n*, 343 U.S. 414, 423-424 (at pp. 155-6).

Within the referenced cited holding of the Supreme Court in the *Pennsylvania* case, the Supreme Court held, 343 U.S. 422:

> * * * To the extent that Penn Water is being controlled, it is by the Commission acting under statutory authority, not by Consolidated acting under the authority of private contract terms "legalized by the Commission. The duty of Penn Water to continue its coordinated operations with Consolidated springs from the Commission's authority, not from the law of private contracts.

Enforceability of Certificated Arrangements—Upon

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commencement of jurisdictional sales or services,[2] this Commission has full authority to enforce the rendition

2. The exclusion of the production and gathering functions from the jurisdictional coverage of the Natural Gas Act, 15 U.S.C. 717(b), does not defeat the Commission's plenary regulatory authority over "* * * (1) the transportation of natural gas in interstate commerce; (2) its sale in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale * * *". *FPC v. Louisiana Power & Light supra* @ p. 636; or preclude the Commission from considering production and gathering when relevant to the exercise of the Commission's authority to regulate such transportation, sales or companies. *FPC v. Transcontinental Gas Corp.*, 365 U.S. 1, 26 (1961).

of, *inter alia,* natural gas services, sales or operations, as certificated by the Commission, including as a part thereof, necessary deliverability or production of natural gas to meet, *inter alia,* certificated operations, services, developments, quantities, volumes or sales.

As certificated, such factors may or may not accord with the terms of sales or other contractual arrangements among natural gas producers, pipelines or distributors in seeking Commission authority to engage in jurisdictional sales or services. To the extent that contractual obligations coincide with the certification authority, these factors are thus also enforceable as a matter of private contract law. However, it is the statutory standards of the Natural Gas Act which ultimately control the terms under which natural gas companies may operate jurisdictional facilities and engage in jurisdictional transactions. Certificated obligations are enforceable by pipelines as a matter of the private law of contracts as well as by this Commission as a matter of public regulatory law.

Subsection 7(e) of that Act, 15 U.S.C. 717f(e), provides "* * * The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require. * * *" This conditioning authority is a broad authorization, as pointed out by the Supreme Court in

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Atlantic Ref. Co. v. *Pub. Serv. Comm'n,* 360 U.S. 378, 389 (1959):

> * * * Section 7(e) vests in the Commission control

> over the conditions under which gas may be initially dedicated to interstate use. Moreover, once so dedicated there can be no withdrawal of that supply from continued interstate movement without Commission approval. * * *[3]

In addition to Commission initiated proceedings, certificate, rate schedule or contractual obligations of any natural gas company producer or natural gas company pipeline may be made the subject of appropriate complaint proceedings before the Commission. Section 1.6 of the Commission's Rules of Practice and Procedure provides in part, 18 CFR 1.6(a):

> Any person, including any State or local commission, complaining of anything done or omitted to be done by any * * * natural gas company in contravention of an act, rule, regulation or order administered or issued by the Commission, may file complaint with the Commission.

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Section 16 of the Natural Gas Act, 15 U.S.C. 717o, confers upon the Commission "* * * power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules and regulations as it may find necessary or appropriate to carry out the provisions of this act. * * *" This is a most broad authority. *FPC* v.

---

3. See also, *Mitchell Energy Corporation,* Opinion No. 733, issued June 11, 1975, ____F.P.C.____, (appeal pending, *Mitchell Energy Corporation v. FPC,* CA 5, No. 75-3110, and *El Paso Natural Gas Company, et al.,* Opinion No. 737, issued July 11, 1975, ____ FPC____, (appeal pending *sub nom., Southland Royalty Co., et al. v. FPC,* CA 5, No. 75-2851.

Louisiana Power & Light Co., supra, @ p 642. Judicial enforcement authority obtains for Commission use pursuant to Section 20 of the Natural Gas Act, 15 U.S.C. 717s; criminal penalty provisions are set forth in Section 21 of the Act, 15 U.S.C. 717t.

In addition to the foregoing provisions, affected parties may well have numerous judicial remedies available to enforce certificate rate schedule or contractual obligations of any natural gas company producer, natural gas company pipeline or natural gas distributor.

The Commission further finds:

(1) Prior notice and opportunity for public participation in this proceeding promulgating this Statement of Policy is not required either pursuant to the provisions of the Natural Gas Act, 15 U.S.C. 717(a) *et seq.*, or the provisions of the Administrative Procedure Act, 5 U.S.C Subchapter II, 553. Moreover, compliance with the effective date requirements of 5 U.S.C. 553(d), is not required since this Statement of Policy does not prescribe an added duty or restriction.

(2) It is necessary and appropriate for purposes of administration of the provisions of the Natural Gas Act, 15 U.S.C. 717(a) *et seq.*, to amend Part 2, General Policy and Interpretations, Subchapter A, General Rules, Chapter I, Title 18, Code of Federal Regulations, by the inclusion therein of Section 2.83, Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Services Under Certificated Arrangements, all in the manner hereinafter directed.

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The Commission, acting pursuant to the provisions of the Natural Gas Act, particularly Sections 4, 5, 7, 16, 20 and 21 thereof (52 Stat. 822, 823, 824, 825, 830, 832, 833; 56 Stat. 83, 84; 61 Stat. 459; 76 Stat. 72; and 15 U.S.C. 717c, d, f, o, s and t, *orders*:

(A) Part 2, General Policy and Interpretations, Subchapter A, General Rules, Chapter I, Title 18, Code of Federal Regulations, is hereby amended by adding a new Section 2.83 to read as follows:

2.83 *Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Services Under Certificated Arrangements.*

(a) Natural gas companies within the meaning of Section 2(6) of the Natural Gas Act (whether producers or pipelines) shall comply with all deliverability or production of natural gas requirements to meet, *inter alia,* certificated operations, services, developments, quantities, volumes or sales. The Standards of compliance shall be the controlling statutory standards of the Natural Gas Act, chiefly those of Sections 4, 5 and 7 thereof. The certificate of the Commission authorizing jurisdictional transactions under the Natural Gas Act shall be deemed evidence of those requirements, whether or not specifically reproduced within the certificate document or order. Natural gas pipeline companies and natural gas producers have obligations arising from the Natural Gas Act with respect to, *inter alia,* deliverability and receipt of certificated volumes of natural gas supplies, violation of which obligations will subject either to the sanction and/or penalty provisions of that Act. While this Commission is charged with responsibility for the administration of the Natural

Gas Act, regulated pipelines and producers have affirmative obligations to enforce delivery of certificated volumes of natural gas supplies by reason of the requirements of that Act.

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(b) The Commission, acting upon its own motion, will undertake appropriate enforcement proceedings either before the Commission or the Courts to ensure compliance with all delivery or production of natural gas requirements to meet certificated operations, services, developments, quantities, volumes or sales as referred to in paragraph (a) *supra*.

(c) The Commission invites, and will entertain, complaints pursuant to Section 1.6 of the Commission's Rules of Practice and Procedure seeking enforcement of certificate, rate schedule or contractual obligations of any natural gas company producer or natural gas company pipeline with reference to matters set forth in paragraph (a) *supra*.

(d) The Commission shall include, subsequent to the date of Order No. 539, the following general language within the Commission's Order Issuing Such Certificate Temporary Or Permanent:

> Applicant natural gas company's attention is directed to Commission Order No. 539, issued October 14, 1975, F.R. , and to the provisions of Section 2.83 General Policy and Interpretations, 18 CFR 2.83. Moreover, issuance of this certificate authorization is conditioned to require Applicant, within 30 days of the initial reserve determination or any subsequent redetermination thereof, to report the results of each such initial or redetermination study to the Commission. The certificated minimum daily delivery

obligation of the seller (1) shall be determined in accordance with applicable provisions specifically

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set forth in seller's contract unless otherwise changed by the certificate authorization, (2) shall be without regard to any contractual reservations contrary to the certificate authorization, (3) and shall remain in full force and effect unless and until changed by appropriate certificate authorization amendment based upon Applicant's full documentation of, *inter alia*, the reasons for any such proposed amendment, the sales production history, the amount of remaining connected reserves of Applicant dedicated under the contract and the status of Applicant's nondeveloped reserves dedicated under the contract. The certificate authorization is further conditioned to require that Applicant, if it has not secured an appropriate certificate amendment and there are circumstances resulting in the delivery of a lesser quantity of natural gas than any certificated delivery obligation, Applicant shall file for each contract year quarter, a verified report setting out the circumstances of such lesser deliveries and the corrective actions which Applicant proposes to undertake in order to meet any experienced delivery deficiency, such verified reports to be filed within 10 calendar days after expiration of each contract year quarter.

(e) Nothing herein contained shall be deemed to preclude the exercise of any other administrative

or judicial remedies which might otherwise obtain to any person.

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(f) Nothing herein amends, modifies or changes any existing authorization for jurisdictional transactions as now certified or authorized by the Commission pursuant to the provisions of the Natural Gas Act, Sections 4, 5 or 7 thereof.

(B) The amendment provided for herein shall be effective as of the date of issuance of this order.

(C) The Secretary of the Commission shall cause prompt publication of this order to be made in the Federal Register.

By the Commission.

(S E A L)

Kenneth F. Plumb,
Secretary.

* * *

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Services Under Certificated Arrangements	))))	Docket No. RM76-8

APPLICATION FOR REHEARING
AND
MOTION FOR RECONSIDERATION

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November 11, 1975

[Additional Applicants Listed on the Following Pages]

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Services Under Certificated Arrangements	))))	Docket No. RM76-8

APPLICATION FOR REHEARING
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November 11, 1975

[Additional Applicants Listed on the Following Pages]

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Services Under Certificated Arrangements	))))	Docket No. RM76-8

APPLICATION FOR REHEARING
AND
MOTION FOR RECONSIDERATION

The undersigned producers (Shell Oil Company, *et al.*, hereinafter designated "Producers") in accordance with Section 19(a) of the Natural Gas Act and Section 1.34 of the Commission's Rules of Practice and Procedure, apply for rehearing of Commission's Order No. 539, Promulgating Statement of Policy issued October 14, 1975, or in the alternative move the Commission for reconsideration of that Order. In support of this Application, Producers allege and state the following:

I

Order No. 539 is apparently responsive to inquiries by Congressional Committees and others to determine whether or not producers are in some way failing to meet their contract obligations to deliver gas supplies to their pipeline purchasers, and whether this Commission or the pipeline purchasers have been unable or unwilling to en-

force these contractual obligations. The undersigned Producers wish to state that any assumption that producers are failing to perform their contract obligations is absolutely and completely contrary to fact. Producers are in compliance with their contracts to deliver gas to their pipeline purchasers. There have been no lawsuits by pipelines seeking to enforce the delivery requirements in producer contracts because there have been no violations by the producers of those requirements. We believe, however, that the Commission's Order improperly characterizes the obligation of producers either under their contracts or

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conditions contained in a certificate authorizing sale. There have been obvious misconstruction of the Natural Gas Act, and misunderstandings of the contractual commitments of the parties, the physical properties of oil and gas reservoirs, the legal effect of certificate conditions by some persons unfamiliar with the industry, or the delivery provisions of the contracts. We have therefore attached hereto as Appendix A certain representative contracts which we believe are typical of contracts executed at various time periods over the last fifteen (15) years. These typical contracts do not guarantee delivery of specific quantities of gas or rates of delivery. This is because all gas wells will deplete at varying rates, dependent on reservoir characteristics, and specific levels of production cannot possibly be guaranteed. Contracts similar to those attached have been customarily utilized by the industry for many years. They conform to the realities of nature in the production and depletion of a natural resource.

It is the belief of Producers that Section 2.83 of Order No. 539 could be construed as requiring producers to deliver, under typical contracts, fixed quantities of gas, on a daily, monthly and/or annual basis. This is an incorrect interpretation of these contracts and would effectively convert such contracts into a form of warranty obligation. The quantities stated in the typical producer gas sales contracts are inserted for the protection of buyers (usually pipeline companies) as a maximum limitation on their initial take-or-pay obligation under the contracts. These typical producer gas sales contracts do not obligate the producer to deliver this or any specific quantity of gas. The producer's contract may provide for the delivery of a percentage of the gas currently capable of being produced, sometimes called the deliverability or deliverable capacity or productive capacity, see Appendix A. However, failure to produce this percentage of gas can have the consequence only of reduction of buyer's take-or-pay obligation. This is the penalty the producer incurs. However, the producer's obligation to produce is implicit in his legal obligations to act as a prudent operator under his oil or gas lease.

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The contract quantity for a field is determined either by the deliverability capacity taken by actual measurement of the wells, or by proportion of the total reserves contained in the field, as that figure fluctuates and varies throughout the life of the field. Attached hereto as Appendix B is a graph of a typical field showing actual deliveries and the decline over time in deliverability as determined by semi-annual tests. Thus, while the sample

billing statement filed with the initial rate schedule contains a rough estimate of deliveries to be made during the first month, it is an estimate only for that time period, and has no bearing whatsoever on contract obligations. The only purpose of the sample billing statement is to indicate the estimated impact of the applicable ceiling price.

When the field is initially produced, its productive capacity is normally determined in order that there can be a determination of a minimum daily contract quantity the buyer is obligated to pay for if he does not accept its delivery. For example, paragraph 4.2 of the Gas Purchase and Sale Contract executed August 21, 1975 attached as Appendix A, Schedule 3 requires the buyer to purchase and take from seller, and if available and not taken, buyer shall pay seller for a daily contract quantity of gas equal to ninety (90) percent of Delivery Capacity. The Contract defines "Delivery Capacity" as the maximum daily quantity of Gas Well Gas which, in the course of prudent operation, as determined by seller in good faith, can be delivered to buyer from seller's interest in the properties. Thus, it is necessary to test the field by letting the gas wells flow at their maximum capacity, under prudent operating conditions, to determine the maximum daily quantity of gas that can be delivered to the buyer. Under the circumstances set forth in this example, the buyer would be obligated to take or pay for a daily contract quantity representing a percentage of the maximum daily quantity as shown by such test. As the gas field matures in its development, State or Federal Regulations normally require further tests to determine the maximum daily quantity of gas that can be produced and the results of such tests may increase or reduce the daily contract quantity the buyer

is obligated to take or pay for if the gas is available and not taken.

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At some time, depending on the buyer's requirements, a point is reached where the gas wells produce at their maximum capacity and thus, productive capacity coincides with actual production and would normally continue to do so until the field is depleted.

In every contract that we are familiar with, the contract clearly reserves to the producer all of the rights to maintain full control over the development and operation of the field. The rate of development of the field and the rate of decline of production, as the field depletes, are determined by the following factors:

(a) The producible reserves in the field and the physical ability of the gas sands to deliver the gas to the well bore.

(b) The rate of development of the field and the density at which the wells are drilled.

(c) Spacing laws and other orders of the state and federal regulatory bodies enacted to prevent waste of gas in the producing fields.

(d) Contractual obligations between lessor and lessee, which require the lessee to develop the fields as an "ordinary prudent operator" and to diligently market the gas which he has developed.

Under the *Mobile-Memphis* doctrine, the producers

have retained the right to contract for the sale of their gas to the pipeline companies, subject only to the approval authority of the Federal Power Commission. Producers have no objection to certificate conditions or other Commission orders which require them to comply with their contractual provisions. In fact, no such orders are necessary, as the pipeline purchasers and other parties have full rights to enforce their contracts in court. The Commission, in its first finding (p. 8) stated that its present "'statement of policy does not prescribe any added duty or restriction." This statement

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conflicts with Section 2.83 of the Commission's proposed Regulation. If Section 2.83 of the Commission's proposed Regulations is intended to do nothing more than to require producers to comply with their contracts, the undersigned Producers have no objection to such provision, but believe that the Commission's Order should be clarified. If, however, this Section is intended to impose certificate conditions requiring producers to deliver specific quantities of gas in return for receiving certificates, then the Commission has exceeded its authority under the Natural Gas Act, and is contemplating drastic changes in the structure of the industry which are not in the national interest. A contract to sell gas over a long term must be contingent upon the ability of the reservoir to supply the gas being sold. The producer cannot "guarantee" that a gas reservoir will continue to produce at any given rate. This is not to say that the producer is not willing to perform as an ordinary prudent operator and to fully develop the reservoirs. But the Commission can-

not and should not attempt to force a producer to "guarantee" to produce gas from the wells which are physically incapable of producing. The analogy of the ability to obtain blood from a turnip is apropos here.

Neither the pipeline purchaser nor the Federal Power Commission is given, by either the gas sales contract or the Natural Gas Act, the power to control production operations in the field, see Section I(b) of the Natural Gas Act; *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954); *Deep South Oil Company v. F.P.C.*, 247 F.2d 882, 889 (5th Cir. 1957); *F.P.C. v. Panhandle Eastern Pipeline Co.*, 337 U.S. 498 (1949).

If the Commission does intend to change its current policy regarding certificate applications and conditions to be applied thereto, as a minimum and Commission is required to give Notice and receive Comments in which the parties are given an oportunity to state their positions, see *Mobil Oil Corporation v. F.P.C.*, 483 F.2d 1238 (D.C. Cir. 1973), before issuing a major Statement of Policy. The Commission should rescind Order No. 539 and afford the parties due process of law.

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II

WHEREFORE, the undersigned Producers respectfully request that the Commission reconsider its Order No. 539, and clarify that Order to eliminate the requirement that the seller's delivery obligations cannot be changed without certificate authorization, and to remove

any implication that the certificate will require some delivery obligation other than those required by contract.

Respectfully submitted,

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VERIFICATION

THE STATE OF TEXAS

COUNTY OF HARRIS

THOMAS G. JOHNSON, being duly sworn, deposes and says that he is an attorney for Shell Oil Company; that he is authorized to verify and file this document; that he has examined the statements contained therein, and that all such statements are true and correct to the best of his knowledge, information and belief, and that he has been duly empowered and authorized to subscribe said instrument and to execute this verification on behalf of Shell Oil Company and each of the Producer Applicants joining in said Application for Rehearing and Motion for Reconsideration.

THOMAS G. JOHNSON
Thomas G. Johnson

Subscribed and sworn to before me, this 11th day of November, 1975.

DELIA GONZALEZ
Delia Gonzalez
Notary Public in and for
Harris County, Texas

My Commission Expires June 1, 1977.

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CERTIFICATE OF SERVICE

I hereby certify that I was advised on this date by the Office of the Secretary of the Commission that no service was required on any person other than the Commission, and that filing with the Secretary would constitute compliance with the requirement of Section 1.17 of the Rules of Practice and Procedure.

Dated in Houston, Texas, this 11th day of November, 1975.

THOMAS G. JOHNSON
Thomas G. Johnson

Of Counsel for

Shell Oil Company

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APPENDIX A

SCHEDULE 1

FPC GAS RATE SCHEDULE

OF

SHELL OIL COMPANY

FILED WITH

FEDERAL POWER COMMISSION

WEST WAHA FIELD

REEVES COUNTY, TEXAS

NO. 318

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SHELL OIL COMPANY

GAS STATEMENT

El Paso Natural Gas Company
P.O. Box 1492
El Paso, Texas 79999

West Waha Field
Reeves County,
Texas

Estimated sales and billings for first month of service:

MCF 14.65 PSIA	Base Price Per MCF	Tax Reimbursement Per MCF	Rate Per MCF	Total Value
1,095,850	16.5¢	(1)	16.5¢	$180,815.25

(1) Currently not applicable.

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GAS PURCHASE AGREEMENT

THIS AGREEMENT, made and entered into on this the 3rd day of February, 1966, by and between EL PASO NATURAL GAS COMPANY, a Delaware corporation, hereinafter called "Buyer", and SHELL OIL COMPANY, a Delaware corporation, hereinafter called "Seller",

WITNESSETH:

That, in consideration of the mutual covenants and agreements herein contained the parties hereto agree as follows:

ARTICLE I

Definitions

Section 1. The term "Seller's properties" as used in this agreement shall mean Seller's interest in the oil and gas leases or oil, gas and mineral leases and the lands covered thereby described in Exhibit "A", hereto attached and hereby made a part hereof.

Section 2. The term "pipeline facilities" as used in this agreement shall mean gas pipeline transmission facilities, together with field processing and gathering facilities, sufficient to permit Buyer to receive deliveries of gas under this agreement and market the same.

Section 3. The term "gas well" or "well" as used in this agreement shall mean any well completion located on Seller's properties classified as a gas well by the Railroad Commission of Texas or other governmental authority having jurisdiction.

Section 4. The term "gas" or the term "natural gas" as used in this agreement shall mean gas produced from any well classified as a gas well by the Railroad Commission of Texas or other governmental authority having jurisdiction.

Section 5. The term "day" as used in this agreement shall mean a period of twenty-four (24) consecutive hours beginning at seven (7:00) o'clock A.M.

Section 6. The term "month" as used in this agreement shall mean the period beginning at seven (7:00) o'clock A.M. on the first day of a calendar month and ending at seven (7:00) o'clock A.M. on the first day of the next succeeding calendar month.

Section 7. The term "year" as used in this agreement shall mean the period beginning at seven (7:00) o'clock A.M. on the first day of a calendar year and ending at seven (7:00) o'clock A.M. on the first day of the next succeeding calendar year; provided, however, that the period from the date of first deliveries of gas hereunder until the first day of the next succeeding calendar year shall be deemed to be a year, and the period from seven (7:00) o'clock A.M. on the first day of the last calendar year during the term of this agreement until seven (7:00) o'clock A.M. on the day next succeeding the day when this agreement terminates shall be deemed to be a year.

ARTICLE II

Preliminary Requirements

Section 1. Buyer represents that it holds a Certificate

of Public Convenience and Necessity issued by the Federal Power Commission (or otherwise has the necessary authority) covering the construction, ownership and operation of the facilities necessary in order for Buyer to perform its obligations under the provisions of this agreement. Promptly after the date of this agreement, and from time to time thereafter as may be necessary, Seller shall make such applications and filings to and with the Federal Power Commission as may be required on the part of Seller in order to procure such Certificate of Public Convenience and Necessity and other approvals as may be necessary in order for Seller to effect delivery of gas under the provisions of this agreement or to otherwise perform its obligations hereunder. Seller further agrees to furnish to Buyer copies of all such filings, and copies of all orders, communications, etc., that Seller may receive from such Commission with respect to the sale of gas hereunder.

Section 2. If on January 1, 1967 Seller shall not have received and accepted the Certificate of Public Convenience and Necessity referred to in Section 1 of this article, then either Buyer or Seller may, at any time thereafter, while such condition continues, give written notice to the other party that it desires to terminate this agreement. If any such notice is given this agreement shall terminate thirty (30) days after the date on which such notice is given unless at the end of such thirty (30) day period Seller shall have received and accepted said Certificate of Public Convenience and Necessity. If this agreement shall terminate

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pursuant to the provisions of this section neither Buyer nor Seller shall thereafter have any further liability under this agreement to the other, except as to obligations therefore accrued hereunder.

Section 3. If Seller shall receive and accept the Certificate of Public Convenience and Necessity referred to in Section 1 of this article prior to any termination of this agreement pursuant to the provisions of Section 2 of this article, Buyer shall promptly thereafter proceed, at its sole cost and expense, to obtain the necessary rights-of-way and land and to design, acquire materials for and construct the pipeline facilities. All such procurement and construction shall be prosecuted with diligence to completion. First delivery of gas shall commence under this agreement on (1) the date that said pipeline facilities have been completed and are ready to be placed in operation, or (2) on the first day of the month following the month in which Seller shall have received and accepted the Certificate of Public Convenience and Necessity referred to in Section 1 of this article; whichever date is earlier.

ARTICLE III

Quantities

Section 1. Commencing as of the date of the first deliveries of gas hereunder and continuing during the term hereof, Seller shall sell and deliver to Buyer from Seller's properties, and Buyer shall

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purchase and receive from Seller from said properties and

pay for, or pay for whether or not received, during each year, subject to the further provisions of this Article III, a minimum quantity of gas per day determined as provided in Article IV of this agreement. Such minimum quantity shall, subject to Section 3 of Article IV hereof, be averaged over each year unless otherwise stated. In addition, Buyer shall have the right to purchase and receive from Seller during the term of this agreement such quantities of gas produced from said properties in addition to said minimum as Buyer may desire, and Seller shall sell and deliver the same to Buyer; provided that the rate of production from Seller's properties shall not exceed the maximum rate of production established therefor by any state or federal regulatory body having jurisdiction; and provided further, that Seller shall not be required to deliver gas from Seller's properties in quantities which would, in the sole judgment of Seller, damage Seller's wells or the reservoir from which said gas is produced.

Section 2. Should Buyer fail to purchase and receive from Seller during any year the minimum quantities of gas which Buyer was required to purchase and receive from Seller during such year pursuant to the provisions of Section 1 of this Article III, which failure was not due to physical nonavailability of gas, causes within the control of Seller, regulation by governmental authority or force majeure intervention, then within thirty (30) days after the end of such year Buyer shall pay Seller for that quantity of gas which represents the difference between the minimum quantities

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of gas which Buyer was required hereunder to purchase

and receive from Seller during such year and the quantities of gas actually purchased and received by Buyer from Seller's properties during such year. Payment shall be made at the average price, weighted as to volume, paid by Buyer hereunder for gas during such year. If in any year Buyer fails to purchase and receive from Seller's properties during such year the minimum quantities of gas which Buyer was required to purchase and receive from Seller's properties during such year pursuant to the provisions of Section 1 of this Article III, Buyer shall have the right at any time during the remaining term of this agreement to take and receive the quantity of gas which it paid for but did not receive during the year when such deficiency occurred and shall be required to pay therefor only the difference, if any, between the price in effect under this agreement at the time of delivery and the amount actually paid for the deficiency; provided, however, that the quantity of gas so taken by Buyer shall not be treated as a part of the minimum quantities of gas which Buyer is obligated to purchase and receive hereunder during any of such succeeding years.

Section 3. Anything contained in this agreement to the contrary notwithstanding, Buyer shall never be obligated to receive and pay for, or pay for though not received, a greater quantity of gas from Seller's properties in any year than seventy-five per cent (75%) of the quantities of gas physically available for delivery to Buyer from said properties under the provisions of this agreement during such year.

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ARTICLE IV

Minimum Purchase Obligations

Section 1. For the period commencing on the date of first delivery of gas hereunder and continuing until January 1, 1970, the minimum daily quantity of gas averaged over each year to be purchased by Buyer from Seller hereunder shall be Seller's interest in fifty million (50,000,000) cubic feet of gas per day from wells located on the lands described in Exhibit "A" hereto.

Section 2. Commencing on January 1, 1970 and continuing for the remainder of the term hereof, the minimum daily quantity of gas averaged over each year to be purchased by Buyer from Seller's properties shall be that quantity of gas determined as to said properties pursuant to the formula set out in Section 3 of Article V hereof.

Section 3. During any year when the production of gas from Seller's properties is subject to allocation under the laws, orders, rules and regulations of governmental authority based on nominations made by pipeline purchasers and Buyer has nominated to such authority a volume of gas averaged over such year equal to or greater than the minimum daily quantities as determined pursuant to Section 1 and/or Section 2 of this article for such year, then the minimum daily quantities of gas Buyer is obligated to take and pay for, or pay for though not received for such year, shall be the lesser of (1) the volumes of gas so allocated to Seller's properties by governmental authority, or (2) said minimum daily quantities of gas determined pursuant to Section 1 and/or Section 2 of this article.

In the event Buyer's nominations averaged over such year are less than the minimum daily quantities of gas as determined

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pursuant to Section 1 and/or Section 2 of this article, Buyer's minimum obligation to take and pay for, or pay for though not received for such year, shall be that volume of gas which would have represented Buyer's obligation if Buyer's nominations had been equal to the minimum daily quantity of gas as determined pursuant to Section 1 and/or Section 2 of this article.

Section 4. Anything herein contained to the contrary notwithstanding, but subject to the provisions of Article XXI hereof, Buyer agrees to accept delivery (during each month following the month during which first deliveries of gas occur) from Seller's properties quantities of gas from each and every one of the wells located on said properties and connected to Buyer's gathering system having a value of not less than five hundred dollars ($500.00) (such amount to be reduced proportionately if Seller owns less than one hundred per cent (100%) of the working interest in said properties); provided, however, that such quantities meet the pressure and quality requirements of this agreement and are available and tendered to Buyer by Seller at the delivery point or points hereunder.

Section 5. Buyer agrees that its takes of gas from Seller's wells will be at least ratable with the production of gas from wells belonging to others and completed in the same reservoir in which Seller's wells are completed, whether such other wells be connected to Buyer's gather-

ing system or to the system of another purchaser. Determination of whether or not production is ratable shall be in accordance with the applicable rules and regulations

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established by duly constituted governmental authorities having jurisdiction thereof.

Section 6. Commencing (1) on the first day of the month following the month in which Seller shall have received and accepted the Certificate of Public Convenience and Necessity referred to in Section 1 of Article II hereof, or (2) July 1, 1966, whichever date is earlier, and continuing as to each subsequent month a payment on or before the tenth (10) day of the following month shall be made to Seller at the rate set forth in Article XIII hereof for such month for a volume of gas determined as follows: A minimum daily quantity of gas as determined in accordance with the provisions of Sections 1 and/or 2 of this Article IV; subject to such quantities being available from Seller's well or wells, in accordance with applicable rules and regulations of the Railroad Commission of Texas. Such quantities shall be then multiplied by the applicable number of calendar days to determine the minimum monthly quantities of gas for which payment shall be made to Seller pursuant to this section. The provisions of Article XXI shall not be applicable to excuse the payments required under this Section 6. Monthly payments made Seller pursuant to this Section 6 shall terminate on the date of actual deliveries of gas hereunder. At such time as actual deliveries of gas commence hereunder, all such payments shall be considered as payments for gas not taken, within the meaning

of Section 2 of Article III hereof, and Buyer's rights of make-up as respect to such quantities of gas shall be available pursuant to said Section 2.

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In the event this agreement is terminated pursuant to the provisions of Section 2 of Article II hereof, payments made by Buyer to Seller under this Section 6 shall be refunded by Seller to Buyer without interest.

ARTICLE V

Dedication and Determination of Reserves

Section 1. Seller hereby dedicates to the performance of this agreement Seller's interest in all recoverable gas reserves underlying Seller's properties.

Section 2. Not less than thirty (30) nor more than sixty (60) days prior to January 1, 1970, and thereafter not less than thirty (30) nor more than sixty (60) days prior to each biennial anniversary of such date, Buyer shall furnish Seller its estimate of the reserves of recoverable gas then remaining which can thereafter be produced from then existing wells on Seller's properties in satisfaction of the delivery obligations of Seller under this agreement. If Seller shall fail during the thirty (30) day period following receipt of such estimates to give written notice to Buyer taking exception to the quantities shown therein, Buyer's estimates shall prevail for all purposes of this agreement. If Seller shall give Buyer written notice within such thirty (30) day period taking exception to the quantities estimated by Buyer, representatives of the parties shall promptly meet for the purpose

of reconciling their respective estimates, but if no agreement with respect thereto is reached within thirty (30) days after Seller's notice to Buyer, then

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such quantities shall be determined independently in the manner set forth in Section 4 of this Article V.

To the quantity of reserves of recoverable gas determined as to Seller's properties by the last such study there shall be added the quantity of gas theretofore delivered to Buyer from said properties under this agreement. Such quantity of gas is hereinafter in this article called the "contract reserves".

Section 3. The number of billions of cubic feet of gas found by the last reserve study to constitute the contract reserves as to Seller's properties shall be divided by eight (8) and the quotient so obtained shall be multiplied by one million (1,000,000). The product of such multiplication shall be the number of cubic feet of gas as to Seller's properties which represents the daily quantity of gas referred to in Section 2 of Article IV hereof.

Section 4. If any of the reserve determinations required to be made under the provisions of Section 2 of this Article V shall result in disagreement between Buyer and Seller, they shall select a competent geologist or reservoir engineer to determine such quantity of reserves by his independent calculation, and the results of his findings shall be binding upon both parties. The appointment shall be made in the following manner: Either party may, within thirty (30) days after completion of a joint study, notify the other of its disagreement with the conclusions

of such other party and nominate the independent geologist or reservoir engineer. Within ten (10) days after the notice is given, the other party shall accept such nomination or make its own nomination.

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If within ten (10) days of the date of such reply the parties are unable to agree on a nomination, the appointment of the independent geologist or reservoir engineer may be made upon written request of either party by the Judge of the United States District Court, senior in service, in the district in which the gas is being sold. All expenses in connection with such determination, including reasonable compensation to such geologist or reservoir engineer, shall be divided equally between the parties hereto, with the exception of the expenses of counsel, witnesses and employees of the parties hereto, which will be borne by the party incurring them.

Section 5. Seller shall, from time to time, at Buyer's request, make available to Buyer such geological, engineering and production data, not considered as confidential by Seller, as may be reasonably obtained by Seller and which are needed by Buyer for a study of the gas reserves covered hereby and the deliverability thereof, including, but not limited to, shut-in pressure data in the event such pressure data are not otherwise available to Buyer.

ARTICLE VI

Quality

Section 1. The gas to be delivered by Seller to Buyer under the terms of this agreement shall be natural gas as

produced in its natural state from Seller's wells and shall conform to the following specifications (determination as to conformity of the gas with these specifications shall be made in accordance with the generally accepted procedures of the industry):

(a) *Liquids*: The gas shall be free from hydrocarbons

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and water in their liquid state at the temperature and pressure at which delivered. Seller shall install, at its sole cost and expense, all separators and/or other devices which may be found necessary to prevent hydrocarbons and water in their liquid state from entering Buyer's gathering line at the points of delivery hereunder.

(b) *Diluent Content*: The gas shall not contain more than twenty per cent (20%) by volume diluent (herein defined as carbon dioxide and total sulphur). In the event all of the gas being delivered to Buyer from Seller's properties, taken in the aggregate and considered as a commingled stream, shall contain in excess of five per cent (5%) by volume diluent, the price shall be adjusted as specified in Article XIII hereof.

(c) *Oxygen*: The gas shall not at any time have an oxygen content in excess of two-tenths (0.2) of one per cent (1%) by volume, and Seller shall make every reasonable effort to keep the gas free of oxygen.

(d) *Dust, Gums, etc.*: The gas shall be commercially free of dust, gums and other solid matter.

(e) *Temperature*: The temperature of the gas shall not exceed one hundred twenty degrees (120°) Farenheit.

(f) *Heating Value*: The total gross heating value of the gas deliverable hereunder shall not be less than one thousand (1,000) British thermal units per cubic foot.

Section 2. If the gas from any well located on Seller's properties shall at any time fail to meet the quality specifications set forth in Section 1 of this article, and if at such time all of the gas being delivered to Buyer from Seller's properties, taken in the aggregate and considered as a commingled stream, shall

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likewise fail to meet such specifications, Buyer may, at its option, refuse to accept deliveries of gas from such well; provided, however, that Seller shall have the right, at its option, at any time within ninety (90) days after Buyer refuses to accept delivery of such gas from such well to commence the construction of treating facilities necessary to cause the gas produced from such well to meet said specifications and shall pursue the construction diligently to completion, in which event Buyer shall continue obligated to purchase gas from such well hereunder so long as the gas tendered from such well continues to meet said specifications and the other requirements of this agreement. In the event Buyer shall refuse to accept deliveries of gas from any such well and Seller shall not elect to install treating facilities as above provided, the gas thereafter produced from such well from the reservoir in which it is then completed and the gas reserves contained in said reservoir underlying the acreage attributable to said well as determined pursuant to Article V hereof shall be released from the provisions of this agreement if Seller shall give Buyer written notice of Seller's desire to obtain

such release and Buyer shall not within sixty (60) days thereafter agree to install and operate, at its sole cost and expense, treating facilities necessary to cause the gas produced from such well to meet said specifications. Except for Seller's obligation to install separators and/or other devices so that the gas delivered hereunder will conform with the quality specifications of subparagraph (a) of Section 1 of this Article VI, Seller shall never be required to treat the gas to render it merchantable.

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ARTICLE VII

Delivery Point

The point of delivery for all gas to be sold and delivered to Buyer hereunder shall be at the mouth of Seller's well or wells or at the outlet of Seller's separator or separators, or compressor or compressors, if installed. Title to and ownership of all gas so delivered hereunder shall pass to and vest in Buyer at such point or points of delivery.

ARTICLE VIII

Delivery Pressure

Section 1. Buyer shall accept delivery of gas hereunder at the natural well flowing pressures at the points of delivery and shall have the right to operate its gathering system at pressures not to exceed twelve hundred pounds (1200#) per square inch gauge. Buyer shall be responsible for overcoming the natural decline in reservoir pressure and shall (subject to the further provisions of this Article VIII) at all times maintain pressures on its gathering system sufficiently low to permit delivery from Seller's wells of the

minimum quantities of gas which Buyer is obligated to purchase from time to time hereunder as determined in accordance with Article IV hereof.

Section 2. Buyer shall have the right to refuse to accept delivery of gas from any well producing at a natural wellhead flowing pressure at the point of delivery for such well of less than two nundred fifty pounds (250#) per square inch gauge; provided, however, that Seller shall have the right, at its option, at any

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time within ninety (90) days after Buyer refuses to accept delivery of gas from any such well to commence the construction of compression facilities necessary to deliver such gas at a pressure of at least two hundred fifty pounds (250#) per square inch gauge, in which event Buyer shall continue obligated to purchase gas (subject to the right granted Buyer pursuant to Article XVIII hereof) from such well hereunder so long as such pressure is maintained and the gas otherwise meets the requirements of this agreement. In the event Buyer shall refuse to accept deliveries from any such well and Seller shall not elect to install compression facilities as above provided, the gas thereafter produced from such well from the reservoir in which it is then completed and the gas reserves contained in said reservoir underlying the acreage attributable to said well as determined pursuant to Article V hereof shall be released from the provisions of this agreement if Seller shall give Buyer written notice of Seller's desire to obtain such release and Buyer shall not within sixty (60) days thereafter agree to accept delivery of such gas at pressures

below two hundred fifty pounds (250#) per square inch gauge.

Section 3. Buyer shall never be obligated to connect any well to its gathering system which is incapable of producing at least one million (1,000,000) cubic feet of gas per day at a natural well flowing pressure at the point of delivery of twelve hundred pounds (1200#) per square inch gauge or the operating pressure of Buyer's gathering system, whichever pressure is the lesser. Seller shall have the right, at its option, at any time within ninety (90) days after Buyer refuses to connect any such well, to proceed to

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construct and thereafter prosecute with diligence to completion, at its sole cost and expense, the necessary connecting line from such well to a mutually agreeable delivery point on Buyer's existing gathering system, in which event, Buyer shall install, maintain and operate, at its sole cost and expense, necessary metering facilities as provided for in Article X hereof for the measuring of gas delivered at such point. When such facilities have been completed and are ready to be placed in operation, first deliveries of gas shall commence from such well under this agreement, and Buyer shall thereafter continue obligated to purchase gas hereunder from such well so long as the gas tendered therefrom continues to meet the other requirements of this agreement. In the event Buyer shall refuse to connect any such well and Seller shall not elect to construct the connecting line as provided for above, then the gas reserves contained in the reservoir in which such well is then completed underlying the acreage at-

tributable to such well, as determined pursuant to Article V hereof, shall be released from the provisions of this agreement.

ARTICLE IX

Responsibility

Buyer shall not be responsible for the gas prior to its delivery hereunder and Seller shall hold Buyer harmless against any damage or injury caused thereby until same has been delivered to Buyer at the delivery point or points specified in Article VII hereof, after which delivery Buyer shall be deemed in exclusive control and possession thereof and responsible for said gas and

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shall hold Seller harmless against any injury or damage caused thereby. Each of the parties shall indemnify and hold the other harmless against any claims for damages arising out of its respective operations and/or facilities installed hereunder.

ARTICLE X

Meters

Section 1. Buyer, at its sole cost and expense, shall install, maintain and operate at each delivery point a standard type orifice meter or meters for the measuring of the quantity of gas delivered hereunder. Orifice meters shall be installed and operated in accordance with the specifications prescribed in Gas Measurement Committee Report No. 3, dated April, 1955, of the Natural Gas Department of the American Gas Association, as supplemented and modified from time to time. Buyer shall cause the charts on such meters to be changed each eight (8) days and at the end of each month, or at such other times as may be agreed upon by the parties hereto. The meters, meter readings and meter charts shall be accessible at all reasonable times to inspection and examination by Seller.

Section 2. From time to time and at least once in each thirty (30) days, the accuracy of Buyer's measuring equipment shall be verified by and at the expense of Buyer. If either party at any time shall notify the other that it desires a special test of any meter, the other party shall cooperate to secure an immediate verification of the accuracy of such meter and joint observation of any adjustments. If any such test shall be requested by Seller and upon such test, the measuring equipment shall be found to be registering correctly, the cost of such test shall be charged to

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Seller, otherwise the cost of all such tests shall be borne by Buyer. Buyer shall give notice to Seller of the time of all tests made pursuant to this article in order that Seller may conveniently have its representative present. Calibration and adjustment of Buyer's meters and changing of charts shall be done only by Buyer.

Section 3. If, upon any test, the percentage of inaccuracy shall be two per cent (2%) or more, the registration of such meter shall be corrected at the rate of such inaccuracy for any period which is definitely known or agreed upon, but in case the period is not definitely known or agreed upon, then for a period extending back one-half

(½) of the time elapsed since the date of the last calibration. Following any test, metering equipment found inaccurate shall be immediately restored by Buyer as closely as possible to a condition of accuracy. If, for any reason, any meter is out of service or out of repair so that the amount of gas delivered cannot be estimated or computed from the reading thereof, the amount of gas delivered through the period such meter is out of service or out of repair shall be estimated and agreed upon by the parties hereto upon the basis of the best data available, using the first of the following methods which is feasible:

a. By using the registration of Seller's check meter if installed and accurately registering.

b. By correcting the error if the percentage of error is ascertainable by calibration test or mathematical calculation.

c. By estimating the quantity of deliveries by deliveries during preceding periods under similar conditions when the meter

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was registering accurately.

Section 4. Seller may, at its option and expense, install and operate check meters to check Buyer's meters, but measurement of gas for the purpose of this agreement shall be by Buyer's meter, except as hereinabove specifically provided to the contrary. Such check meters and equipment shall be so installed as not to interfere with the operation of the meters to be installed and maintained by Buyer at or near the points of delivery.

ARTICLE XI

Units of Volume

Section 1. The unit of volume for all purposes hereunder (except as otherwise specified in Sections 2 and 3 of this Article XI) shall be one thousand (1,000) cubic feet at an absolute pressure of fourteen and sixty-five hundredths pounds (14.65#) per square inch at a temperature of sixty (60) degrees Fahrenheit.

Section 2. The unit of volume for the determination of the gross heating value under subparagraph (f) of Section 1 of Article VI hereof shall be the amount of gas, on a dry basis, which would occupy a volume of one (1) cubic foot at a temperature of sixty (60) degrees Fahrenheit and under a pressure equivalent to thirty (30) inches of mercury at thirty-two (32) degrees Fahrenheit.

Section 3. The unit of volume for determination of quality values under subparagraphs (b) and (c) of Article VI hereof shall be one (1) cubic foot at a temperature of sixty (60) degrees Fahrenheit and under a pressure equivalent to thirty (30) inches of mercury at thirty-two (32) degrees Fahrenheit.

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ARTICLE XII

Gas Measurement

Section 1. The volumes of gas delivered hereunder shall be computed in accordance with the specifications prescribed in Gas Measurement Committee Report No. 3, dated April, 1955, of the Natural Gas Department of the American Gas Association, as supplemented and modified

from time to time, applied in a practical and appropriate manner, and appropriate correction shall be made for deviation of the gas from Boyle's Law in accordance with said Gas Measurement Committee Report No. 3.

Section 2. For the purpose of measurement, the average absolute atmospheric (barometric) pressure shall be assumed to be thirteen and two-tenths pounds (13.2#) to the square inch, regardless of the actual elevation or location of the delivery point above sea level or of variations in such barometric pressure from time to time. For meters of the orifice type, the following factors shall be given due consideration:

a. The temperature of the gas flowing through Buyer's meters shall be obtained by the use of a recording thermometer so installed by Buyer that it may properly record the temperature of such gas. The arithmetical average of the hourly temperature during the period gas passed shall be used to make proper computations of volume hereunder.

b. The specific gravity of the natural gas shall be determined by Buyer each six (6) months on or as near the first of each six (6) months' period as practicable, by means of an

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Edwards Balance or by such other method as may be agreed upon by the parties hereto. Such test shall determine the specific gravity to be used in computations for the measurement of gas delivered during such six (6) months' period.

Section 3. Buyer shall give notice to Seller of the time of all tests of gas delivered hereunder or of any equipment used in measuring or determining the nature or quality of such gas, in order that Seller may conveniently have its representative present. Should Seller not be satisfied with any such tests, it shall so notify Buyer and Buyer shall perform such retests as may be necessary to assure an accurate test.

Section 4. Determination of the gross heating value of the gas delivered hereunder shall be made upon the basis of tests of the metered stream corrected to eliminate the diluent content thereof.

ARTICLE XIII

Price

Section 1. Buyer shall pay Seller for gas purchased hereunder in accordance with the following schedule:

(1) For the period commencing on the date of first delivery of gas hereunder and continuing until January 1, 1968, sixteen and one-half cents (16½¢) per one thousand (1.000) cubic feet.

(2) For the five (5) year period commencing January 1, 1968, seventeen and one-half cents (17½¢) per one thousand (1,000) cubic feet.

(3) For the next five (5) year period and for each succeeding five (5) year period thereafter, the price to be paid by Buyer to Seller for all gas delivered hereunder shall be increased one cent (1¢) per one thousand (1,000) cubic feet over the price in effect during the preceding five (5) year period.

For gas with diluent content in excess of five per cent (5%) by volume, taken in the aggregate and considered as a commingled stream, the above specified prices shall be reduced by an amount

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calculated by multiplying such price by the decimal equivalent of the difference between the actual per cent diluent content of such gas and five per cent (5%).

Section 2. If the Federal Power Commission, or any successor governmental authority having jurisdiction in the premises, shall at any time hereafter prescribe, for the area in which Seller's properties are situated, a higher just and reasonable area rate for the purchase of gas than the price herein provided to be paid, then the price to be paid by Buyer to Seller for gas delivered under the provisions of this agreement shall be increased, effective as of the date such higher price is prescribed, to equal such higher rate; provided, however, that Buyer shall have the right, at its option, to intervene in any area rate proceeding held to give consideration to any area rate higher than those provided for herein, to oppose any such higher area rate, and in the case of any such higher area rate, to seek relief from any regulatory agency or any court having jurisdiction, but such relief, if obtained, shall not result in a price hereunder which is less than the price set out in this Article XIII.

The provisions of this Section 2 shall be null and void and of no force or effect unless and until the same shall be held to be a "permissive" contract provision under Section 154.93, Subchapter E, Chapter I, Title 18 of the

Code of Federal Regulations, by action of the Federal Power Commission in its proposed rule making in Docket R-298, notice of which was issued on January 26, 1966, or in other appropriate proceeding.

ARTICLE XIV

Billing and Payment

Section 1. On or before the tenth (10th) day of each calendar month, Buyer shall render to Seller a statement showing the amount of gas purchased by Buyer hereunder during the preceding calendar month, and payment for such gas less all applicable taxes paid by Buyer for Seller's account (no taxes shall be paid by Buyer

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for Seller's account except by agreement between the parties, unless such payment shall be required by law) shall be made by Buyer to Seller on or before the twenty-fifth (25th) day of the calendar month in which such statement is rendered.

Section 2. Upon request, Buyer shall furnish Seller the measurement charts applicable to any monthly statement. Seller shall return to Buyer all charts after a thirty (30) day period.

Section 3. Any error or discrepancy in charts or statements furnished pursuant to the above shall be promptly reported to Buyer and Buyer shall make proper adjustment thereof within thirty (30) days after final determination of the correct volumes or values involved; provided, however, that if no such errors or discrepancies are reported to Buyer within two (2) years from the date of

such chart or statement the same shall be conclusively deemed to be correct.

Section 4. Seller shall have access to Buyer's records and books at all reasonable hours so far as they affect measurement and settlement for gas sold hereunder.

ARTICLE XV

Taxes

Section 1. Subject to the other provisions of this article, Seller shall pay or cause to be paid all taxes and assessments imposed on Seller with respect to the gas delivered hereunder prior to its delivery to Buyer, and Buyer shall pay or cause to be paid all taxes and assessments imposed upon Buyer with respect to gas delivered hereunder after its receipt by Buyer. Neither party shall be responsible or liable for any taxes or other statutory charges levied or assessed against any of the facilities of the other party used for the purpose of carrying out the provisions of this agreement.

Section 2. Any sales, transaction, occupation, service, production, severance, gathering, transmission, export or excise tax, assessment or fee levied, assessed or fixed by the United States, the State of Texas, or other governmental authority and taxes of a similar nature or equivalent in effect (not including income, excess profits, capital stock, franchise or general property

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taxes) in respect of or applicable to the gas delivered hereunder to Buyer in addition to or greater than those, if any, being levied, assessed or fixed on the date of this

agreement in respect of or applicable to such gas and which Seller may be liable for, either directly or indirectly, or through any obligation to reimburse others, are hereinafter collectively referred to as an "additional tax". It is expressly understood and agreed between the parties hereto that Buyer shall, subject to the conditions hereinafter set forth, pay to Seller three-fourths (¾ths) of any such additional tax. Should Seller so become liable for any such additional tax, Seller shall notify Buyer immediately. Within ninety (90) days after the end of each calendar month, Seller shall prepare and submit to Buyer a statement setting forth the amount of any such additional tax that Seller has paid during such calendar month, and within thirty (30) days after submission of such statement, adjustment between the parties hereto shall be made by Buyer reimbursing Seller to the extent of three-fourths (¾ths) of the amount of any such additional tax which Seller shall have so paid. The tax reimbursement herein provided for shall apply to the total amount of money Seller is required to pay by virtue of any such additional tax but shall not apply to any delinquent interest or penalty payments that may be applicable to any such additional tax. Taxes applicable to any royalty, overriding royalty, production payment or similar interest shall be considered to be covered by the provisions of this Section 2 only if the reimbursement made by Buyer to Seller with respect thereto is passed on by Seller to the owner of such royalty, overriding royalty,

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production payment or similar interest.

ARTICLE XVI

Term

This agreement shall be effective from the date hereof and shall remain in force for a period of twenty (20) years from the date of first deliveries of gas hereunder.

ARTICLE XVII

Connection of Wells

In accordance with the provisions hereof, Buyer shall proceed diligently to connect to its gathering system all gas wells then situated on Seller's properties. Thereafter, as each additional gas well is completed or recompleted on Seller's properties, Seller shall notify Buyer in writing of the completion or recompletion thereof, and Buyer shall, within ninety (90) days after receipt of such notice, connect such well to its gathering system. Buyer's obligation to connect wells to its gathering system shall be subject to the provisions of Section 3 of Article VIII of this agreement.

ARTICLE XVIII

Regulation of Flow

Buyer shall have the right at any and all times to regulate the flow of gas at the delivery points hereunder to meet its fluctuating demands, subject, however, to Seller's control to the extent necessary to prevent such excessive rates of withdrawal as in Seller's opinion may result in well or reservoir damage.

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ARTICLE XIX

Rights-of-Way

Seller hereby grants and assigns to Buyer, insofar as Seller has the right so to do, all requisite easements and rights-of-way over, across and under properties covered hereby owned by or under lease to Seller with full right of ingress and egress for the purpose of constructing and operating gas pipelines, meter stations and other equipment necessary or convenient for carrying out the terms of this agreement and Buyer's obligations hereunder. If Buyer shall deliver to Seller field notes describing any such easement or right-of-way, Seller will execute and deliver to Buyer an appropriate written instrument confirming such easement or right-of-way as so described. Buyer shall have the right to remove, repair and replace all or any part of Buyer's pipelines, meter stations, and other equipment and facilities, at any time during, and within a reasonable time after, the expiration of the term of this agreement.

ARTICLE XX

Title

Seller hereby warrants title to the gas sold by it hereunder and its right to sell the same and warrants that all such gas is owned by Seller free from all liens, encumbrances and adverse claims, including, but not limited to, liens to secure payment of production taxes, severance taxes and other taxes. As between Buyer and Seller, Seller shall at all times have the obligation to make settlement for all royalties, overriding royalties and other payments

due to the owners of the mineral, royalty and other interests under Seller's

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leases, as modified by such assignments, unitization agreements and other documents as may appear of record or otherwise be binding upon Seller, and to make settlements with all other persons having any interest in the gas (or the proceeds of the sale thereof) sold by Seller hereunder. Seller shall save and hold Buyer free and harmless from all suits, actions, debts, accounts, damages, costs, losses and expenses arising from or out of adverse claims of any and all persons to the gas sold by it hereunder or to royalties, overriding royalties or other payments with respect thereto, or to taxes, licenses, fees or charges thereon which are applicable before the title to the gas passes to Buyer or which may be levied and assessed upon the sale thereof to Buyer, subject, however, to the other provisions of this agreement. In case of any adverse claim to the title of any gas bought and sold hereunder, Buyer may, without otherwise affecting this agreement, retain the purchase price thereof up to the amount of such claim, without interest, until such claim is finally determined or until Seller shall furnish Buyer a bond, in form and with sureties acceptable to Buyer, conditioned to save Buyer harmless.

ARTICLE XXI

Force Majeure

Except for Buyer's obligations to make payment for gas delivered hereunder, neither party hereto shall be liable

for any failure to perform the terms of this agreement when such failure is due to "force majeure" as hereinafter defined. The term "force majeure" as employed in this agreement shall mean acts of God,

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strikes, lockouts or industrial disputes or disturbances, civil disturbances, arrests and restraints from rulers or people, interruptions by government or court orders, present and future valid orders of any regulatory body having proper jurisdiction, acts of the public enemy, wars, riots, blockades, insurrections, inability to secure labor or inability to secure materials, including inability to secure materials by reason of allocations promulgated by authorized governmental agencies, epidemics, landslides, lightning, earthquakes, fire, storm, floods, washouts, explosions, breakage or accident to machinery or lines of pipe, freezing of wells or pipelines, the making of repairs or alterations to pipelines or plants, or any other cause, whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming "force majeure". Upon the occurrence of an event constituting "force majeure", the same shall, so far as possible, be remedied with all reasonable dispatch. The settlement of strikes or lockouts or industrial disputes or disturbances shall be entirely within the discretion of the party having the difficulty, and the above requirement that any "force majeure" shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts or industrial disputes or disturbances by acceding to the demands of any opposing party therein when such course is inadvisable in the discretion of the party having the difficulty.

ARTICLE XXII

Rights of Seller

Seller expressly reserves for itself, its successors and

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assigns, the following prior rights with respect to the gas subject hereto:

(a) The right to deliver to lessors under any of the leases subject hereto, gas required in kind to meet the requirements of lessee's obligations under such leases to furnish gas to such lessors.

(b) The right to use gas reasonably required to develop and operate Seller's properties, including, but not limited to, gas for compressor fuel, and for drilling fluid, excluding, however, the gas-lifting of oil and for pressure maintenance or repressuring operations.

(c) The right to sell to others or otherwise dispose of gas from Seller's properties prior to the commencement of first deliveries of gas hereunder.

(d) Subject to the other provisions of this agreement, the control, management and operation of the properties subject to this agreement shall be and remain the exclusive right of Seller. Seller may, in its sole uncontrolled discretion and as it deems advisable, drill new wells, repair or rework old wells, renew or extend in whole or in part any lease or unit, and abandon any well or surrender, terminate or release all or any part of any lease which in Seller's sole opinion is incapable under normal production methods of producing gas in paying or commercial quantities.

(e) The right from time to time to alter any gas unit by increasing or decreasing the acreage contained therein or to pool or combine any lease or unit or any part thereof with other

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properties or to include in any unit any interest in lands covered by such unit not theretofore included in such unit; and in the event of any pooling, unitization or change in any unit, this agreement shall apply to the interest of Seller in the wells subject hereto and to the interest of Seller in the wells on the newly formed or altered unit or units.

All gas taken by Seller pursuant to subparagraphs (a) and (b) above shall be taken upstream from Buyer's metering facilities.

ARTICLE XXIII

Rules and Regulations

This agreement is subject to all present and future valid laws and valid orders, rules and regulations of the United States, the State of Texas, or any duly constituted agency thereof.

ARTICLE XXIV

Notices

Notices to be given hereunder shall be deemed sufficiently given and served when and if deposited in the United States mail, postage prepaid and registered, addressed to Seller at P. O. Box 1509, Midland, Texas

79701, or to Buyer at P. O. Box 1492, El Paso, Texas 79999, as the case may be, or to such other address as either party shall respectively hereafter designate in writing.

Routine communications, including monthly statements and payments shall be considered as duly delivered when mailed by either registered mail or ordinary first class mail, postage prepaid.

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Successors and Assigns

This agreement shall bind and benefit the parties hereto and their respective successors and assigns, provided that no conveyance or transfer of any interest of either party shall be binding upon the other party until such other party has been furnished with written notice and true copy of such conveyance or transfer; provided, further, that either Buyer or Seller, or both, may assign its right, title and interest in, to and by virtue of this agreement, including any and all extensions, renewals, amendments and supplements thereto, to a trustee or trustees, individual or corporate, as security for bonds or other obligations or securities, without such trustee or trustees assuming or becoming in any respect obligated to perform any of the obligations of the assignor, and if any such trustee be a corporation, without its being required by the parties hereto to qualify to do business in the State of Texas, but no such assignment shall serve to relieve the assigning party of its obligations hereunder.

ARTICLE XXVI

Topical Headings

The topical headings used herein are inserted for convenience only and shall not be construed as having any substantive significance or meaning whatsoever or an indicating that all of the provisions of this agreement relating to any particular topic are to be found in any particular article.

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IN WITNESS WHEREOF, the parties hereto have caused this agreement to be duly executed in duplicate originals, on this the day and year first above written.

"BUYER"

El Paso Natural Gas Company

By: V. M. PLUMMER
V. M. Plummer
Attorney-in-Fact

"SELLER"

Shell Oil Company

By: C. P. BRISTOL
Vice President

ATTEST:

R. L. HUGHSTON
Assistant Secretary

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EXHIBIT "A"

This Exhibit "A" is attached to and made a part of agreement between EL PASO NATURAL GAS COMPANY and SHELL OIL COMPANY, dated February 3, 1966:

SELLER'S PROPERTIES:

Lease Number	Description	Acres Gross	Acres Net
J. D. BODKINS Lease UN-33, et al	All of Section 2, PSL, Block C-4, Reeves County, Texas	627	472.65
J. M. RAPE Leases WT-4619, WT-4601 and WT-4602	NE/4 of Section 12 and all of Section 13 and Section 14, PSL, Block C-3, Reeves County, Texas	1440	1085.51
O. P. BECKEN Leases WT-4613, WT-4672, et al	All of Section 11, PSL, Block C-3 Reeves County, Texas	640	361.84
	Total - - - -	2707	1920.00

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APPENDIX A
SCHEDULE 2

SOUTH MARSH ISLAND BLOCK 6
CONTRACT WITH MICHIGAN WISCONSIN

Factors affecting gas delivery and take obligations:

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GAS SALES CONTRACT

THIS AGREEMENT, made and entered into as of the 3rd day of May, 1968, by and between SHELL OIL COMPANY, a corporation of the State of Delaware (hereinafter referred to as "Seller") and MICHIGAN WISCONSIN PIPE LINE COMPANY, a corporation of the State of Delaware (hereinafter referred to as "Buyer");

WITNESSETH:

WHEREAS, Buyer desires to obtain an additional supply of natural gas to supplement and augment the supply now committed to Buyer; and

WHEREAS, Seller owns or controls certain gas reserves underlying lands and leaseholds located in the South Marsh Island Area, Offshore, Louisiana, from which Seller desires to sell gas to Buyer under the terms and conditions hereinafter set forth:

NOW, THEREFORE, in consideration of the mutual covenants hereof, the parties agree together as follows:

ARTICLE I

DEFINITIONS

1. The term "gas well gas" shall mean that part of the effluent produced from a well classified as a gas-well by the regulatory agency having jurisdiction in such matters, which remains in the vapor phase after passing such well effluent through a conventional mechanical separator or separators for the separation of liquids and gas.

2. The term "oil well gas" shall mean that part of the effluent produced from a well classified as an oil-well by the regulatory agency having jurisdiction in such matters which remains in the vapor phase after passing such well effluent

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through a conventional mechanical separator or separators for the separation of liquids and gas.

3. The term "gas", unless the context otherwise requires, shall mean gas well gas, oil well gas, the combination of both, and shall include the residue gas resulting from processing of gas well gas and/or oil well gas.

4. The term "reserves" shall mean the estimated quantities of recoverable gas to be delivered hereunder that remains, as of the date of initial delivery hereunder, in reservoirs which underlie the lands and leaseholds owned or controlled by Seller subject to this Agreement and in which a flowing gas test or a wire line test (Schlumberger Formation Tester or equivalent) in each segment thereof has been made indicating commercial quantities of gas are available.

5. The term "accounting year" shall mean each calendar year or portion thereof, during the term of this Agreement.

6. The term "annual contract quantity" shall mean a quantity of gas equal to the sum of the daily contract quantities in effect during an accounting year.

7. The term "day" shall mean the 24-hour period commencing at seven o'clock (7:00) a.m. Central Time.

8. The term "month" shall mean a calendar month or portion thereof.

9. The unit of volume for all purposes hereunder, unless otherwise herein specified, shall be one cubic foot of gas at a base temperature of sixty (60) degrees Fahrenheit and at an absolute pressure of fifteen and twenty-five one-thousandths (15.025) pounds per square inch and as otherwise provided by the Standard Gas Measurement Law of the State of Louisiana.

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ARTICLE II

CERTIFICATION AND RIGHT OF TERMINATION

1. Both Seller and Buyer agree, upon the execution of this Agreement, to file within thirty (30) days with the Federal Power Commission and to prosecute with due diligence applications for Certificates of Public Convenience and Necessity or such other authorizations as may be necessary to authorize Seller to initiate and carry on the sale of gas contemplated hereunder and to authorize Buyer to construct and operate the facilities necessary to accept and transport the quantities of gas to be purchased hereunder.

2. If either party shall fail to obtain such Certificate or other necessary authorization from the Federal Power Commission containing terms and conditions acceptable to the party to whom issued by August 1, 1968, or if an unacceptable authorization is issued prior to such date, either party may cancel this Agreement by giving written notice thereof to the other party at any time prior to the issuance of acceptable authorizations to both

parties. Each party hereto shall promptly notify the other party in writing when such party has received a Certificate or authorization and whether or not it is acceptable. It is agreed and understood that a determination as to whether or not such Certificate or authorization is acceptable shall be made in the sole and exclusive discretion of the party to whom such Certificate or authorization is issued.

ARTICLE III

RESERVATIONS OF SELLER

1. Seller hereby expressly reserves and excepts from the terms of this Agreement such portion of the gas now underlying the lands and leaseholds subject to this Agreement as may be required in Seller's opinion as a prudent

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operator for processing plant fuel and shrinkage, lease fuel, drilling, deepening, reworking, compression, operating, and gas lifting. Seller also reserves the right to use gas committed hereunder for cycling, repressuring and secondary recovery purposes. Such reservations (except for drilling, deepening and/or reworking) shall be limited to uses associated with Seller's leases hereunder.

2. In addition, Seller hereby expressly reserves and excepts from the terms of this Agreement all gas produced including gas sold to others than Buyer, prior to the date on which Buyer initially takes gas hereunder; provided, however, that any such sales shall be terminated prior to such date.

3. Seller shall have the right to process or have processed at an onshore location all or a portion of the gas deliverable to Buyer hereunder for the removal of liquefiable hydrocarbons. Such processing shall be at the same point on Buyer's 20″ lateral line (or loops thereof) which extends from Eugene Island Block 199 to Buyer's 20″ mainline in the Patterson Field Area, St. Mary Parish, Louisiana at which Seller processes gas delivered under the Gas Sales Contract dated July 18, 1967 between Buyer and Seller. Such processing shall be under conditions acceptable to both parties. Seller shall exercise the right reserved by this Section 3 by giving notice to Buyer within three (3) years from the date of initial delivery hereunder. Title to all products so removed shall remain vested in Seller. Nothing contained herein shall be construed so as to prevent Seller from using conventional separation equipment (which shall include low temperature well head separation units) prior to delivery to Buyer.

If Seller elects to process gas deliverable to Buyer hereunder such processing shall be in a plant owned by Seller or by Seller and others. Seller agrees that gas owned by others than Buyer will not be commingled in such processing plant with gas owned by Buyer (except for minor volumes of flash gas). Seller, to

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the extent it has the right to do so, further agrees that all other producers selling gas to Buyer and delivered by Buyer or such other producer to such plant shall be given the opportunity to participate in such plant on an

equitable basis. Such processing shall be for recovery and disposition solely by Seller (and other plant owners or plant suppliers) of liquefiable hydrocarbons, helium gas to the extent that Seller has the right to extract helium and other constituents of the raw gas stream other than methane (except methane necessarily removed in such processing), it being understood that Buyer shall not acquire any right, title or interest in any products resulting from such processing.

Buyer agrees to install measuring facilities and other facilities necessary to permit the tie-in and the delivery and redelivery of the gas. Buyer's materials and installation of such facilities (including overheads) shall be reimbursed by Seller and Seller (as to its share) shall restore in kind gas vented by Buyer in making tie-in connections. Buyer agrees that in the event Buyer delivers a portion of the gas flowing in its 20″ offshore pipeline or loops thereof to be processed by others than Seller such gas after being processed will not be redelivered into the 20″ offshore pipeline or loops thereof prior to the delivery of Seller's gas to Seller for processing.

Seller's right to process its gas for extraction of liquefiable hydrocarbons is subject to the following general conditions:

(i) Residue gas shall be returned to Buyer without cost to Buyer;

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(ii) Such processing shall not cause a plant volume reduction (consisting of shrinkage resulting from extraction of liquefiable hydrocarbons, plant fuel

and other uses or losses of gas in the plant) of more than ten (10) per cent;

(iii) Such processing shall not render the gas so processed incapable of meeting the quality specifications contained in Article VII of this Agreement; and

(iv) Seller agrees to restore any pressure decline greater than fifty (50) psig resulting from such processing.

Gas processed by Seller in Seller's plant shall be delivered, redelivered, measured and accounted for in accordance with procedures mutually satisfactory to Buyer and Seller.

Seller's plant volume reduction shall be subtracted from the volume delivered at the delivery point, or points, hereunder and the net volume thus obtained shall be used for purposes of computing Buyer's payments hereunder for gas delivered and in determining whether Buyer and Seller have met their delivery and purchase obligations under this Agreement; however, it is agreed that Seller shall have the right to deliver to Buyer, at the delivery point, or points, hereunder, a volume of gas in excess of that volume requested by Buyer equal to the total volume reduction resulting from processing.

All plant operations conducted by Seller shall be at its sole cost and expense and Seller agrees to indemnify and save Buyer harmless from all losses, damages and expenses which may occur or be asserted by reason of accident or occurrences resulting from Seller's exercising its processing rights as provided hereunder.

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In the event gas other than gas delivered under this Agreement is being transported through Buyer's facilities at the point at which Buyer makes delivery of gas to Seller from processing, or in the event Seller's gas delivered to Buyer under this Agreement at some future date is transported through a line other than Buyer's 20″ offshore pipeline, or loops thereof, Seller shall have the right to process a quantity of the commingled gas in Buyer's line referred to above, having a liquefiable hydrocarbon content equal to the total liquefiable hydrocarbon content of the gas delivered by Seller to Buyer under this Agreement.

Buyer agrees that the pressure of the gas at the point at which Buyer makes delivery of gas to Seller for processing shall not be in excess of 1050 psig.

If Seller exercises the right to process its gas as reserved by the first paragraph of this Section 3 of Article III, Buyer shall reduce the amount of its payments for gas deliveries by an amount obtained by multiplying Seller's plant volume reduction by 1.5 cents per Mcf as compensation for transporting the plant volume reduction to the plant delivery point from the point of delivery. It is understood that the foregoing provision of this paragraph shall not be applicable if and to the extent that Seller restores such plant volume reduction in kind from other gas at the plant or such other onshore point or points as may be mutually agreeable to the parties hereto.

4. The obligations of Seller hereunder are subject to the ability of Seller's wells to produce without waste and in accordance with prudent oil and gas field practice, and

Seller shall not be required to produce any well in excess of the maximum rate of flow fixed by law or regulatory body or in excess

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of the maximum efficient rate of flow of such well. The control and operation of Seller's lands and leaseholds producing gas to be sold to Buyer hereunder shall remain the exclusive right of Seller. Seller may also, at its sole discretion, abandon or shut-in any well or surrender, release or terminate any lease.

5. It is understood that certain of Seller's properties subject hereto are now or may hereafter be subject to agreements with other producers providing for the pooling, joint operation and/or unitization of said properties and all or a portion of the gas to be delivered by the Seller to Buyer hereunder shall be the gas attributable and allocated to Seller under the terms of said agreement or agreements as a result of the leases committed thereto.

ARTICLE IV

COMMITMENT OF GAS

1. Subject to the provisions of Article III hereof, Seller commits to the performance of this Agreement Seller's interest now owned or hereafter acquired in all gas which underlie the lands and leaseholds within the areas outlined in Exhibit "A" and which is recoverable from said lands and leaseholds pursuant to the terms and provisions of this Agreement from and after the date hereof. Seller and Buyer agree that the reserves of Seller available for delivery from the lands and leaseholds subject to this

Agreement are 75 billion cubic feet which shall constitute the initial determination of reserves for the purpose of this Agreement.

2. Seller may request in writing one or more redeterminations of reserves hereunder prior to September 1, 1971. Thereafter either Seller or Buyer may request in writing a redetermination of reserves provided, however, such requests shall not be made more often than once each year. Any request for such reserve redetermination must be based upon significant new or different data than that used in the previous determination or redetermination.

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If upon any redetermination of reserves the volume of reserves is less than the volume last previously determined, Seller shall have the right, but not the obligation, to commit within ninety (90) days after the completion of the redetermination such additional gas reserves for delivery at the then existing points of delivery, or at mutually agreed points of delivery on Buyer's pipeline system onshore in the State of Louisiana or in the Gulf of Mexico offshore therefrom, as may be necessary to make available to Buyer reserves from such combined committed reserves equal to the volume last previously determined.

Buyer shall notify Seller in writing, within thirty (30) days after the redetermination of reserves, of the date such redetermination shall become effective, provided that, subject to the provisions of Section 3 of this Article IV, such date shall not be later than sixty (60) days after the completion of the redetermination.

3. If Buyer requires additional authority to enable it to transport or sell all or a portion of the gas committed to the performance of this Agreement following a redetermination of reserves, as provided in Section 2 of this Article IV, Buyer shall notify Seller within thirty (30) days after such redetermination that Buyer will apply to the Federal Power Commission for requisite authority to take such gas, whereupon the effective date of the redetermination shall be postponed pending decision by the Federal Power Commission and construction of any necessary facilities. Thereupon Buyer shall, within ninety (90) days after the date of redetermination of reserves, file with the Federal Power Commission and thereafter prosecute with due diligence an application for such authorization as may be necessary to enable Buyer to take the additional gas. Upon receipt of such authorization, Buyer shall proceed with due diligence to construct

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such facilities as may be required. The redetermination of reserves provided in Section 2 of this Article IV shall be effective as of the first day of the month following the date of completion of the facilities authorized. If Buyer shall fail to obtain such authorization from the Federal Power Commission within twelve (12) months after the date of redetermination of reserves, then at Seller's written request to Buyer, at any time prior to the issuance of such authorization, Buyer shall release such excess reserves.

4. If Buyer and Seller shall be unable to agree on a redetermination of the reserves as provided in Section 2 of this Article IV, the same upon written notice by either

party to the other shall be determined by an independent engineer or geologist (including a member of an independent firm) mutually acceptable to Seller and Buyer. Within fifteen (15) days after the independent engineer or geologist is appointed pursuant to the foregoing provisions of this Section 4 the independent engineer or geologist shall meet, hear the parties hereto with respect to the matter of said reserves, and within thirty (30) days after his appointment he shall arrive at a redetermination of said reserves. Any determination made by such independent engineer or geologist shall be final and binding on the parties hereto. The fee and expenses of such independent engineer or geologist shall be equally divided between Buyer and Seller. In the event Buyer and Seller cannot agree upon an independent engineer or geologist or any such party selected shall fail to submit a written reserve determination as above provided, either party may request in writing that the matter be arbitrated, and within ten (10) days after such request, the same shall be determined by arbitration in the following manner: Buyer shall appoint one arbitrator and Seller shall appoint one arbitrator and the two

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arbitrators so appointed shall select a third arbitrator. If either Buyer or Seller shall fail to appoint an arbitrator within ten (10) days after a request for such appointment is made by the other party in writing, then the party making request for such appointment shall name the second arbitrator. If the two arbitrators so appointed shall fail within ten (10) days after the appointment of the second of them to agree on a third arbitrator, the

arbitrator necessary to complete a board of three arbitrators shall be appointed upon application by either party therefor by the Judge, senior in point of service, of the United States District court for the Eastern District of Louisiana. In the event such Judge should fail or refuse to act within ten (10) days after application has been made, then either party hereto may request the American Arbitration Association to select the arbitrator to complete the Board of three. Within fifteen (15) days after the third arbitrator is appointed pursuant to the foregoing provisions of this section, the arbitrators shall meet, hear the parties with respect to the matter of said reserves, and within thirty (30) days after the selection of the third arbitrator the arbitrators shall arrive at a redetermination of said reserves. Any redetermination agreed to in writing by at least two of said arbitrators shall be final and binding on the parties hereto. All arbitrators appointed pursuant to this Section 4 shall be qualified independent engineers or geologists experienced in the oil and gas industry and competent to pass on the matter of said reserves. Each party hereto shall pay the fees and expenses of the arbitrator selected by it. The fees and expenses of the third arbitrator shall be borne equally by the parties hereto.

5. Upon request, Seller shall promptly furnish Buyer copies of such information as Seller may possess with respect to the lands and leaseholds subject to this Agreement, including but not limited to legal description of such lands and

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leaseholds, gas and liquid production, tests relating to the

ability of wells to produce, pressures, flow characterisics, completion reports, electric logs, core analyses, gas and other fluid analyses, and any and all other information relating to such wells provided, however, that Seller shall not be required to disclose anything which in Seller's sole discretion is of a confidential nature. Seller upon request of Buyer will furnish Buyer each month with copies of all reports filed with the Louisiana Department of Conservation or other regulatory bodies having jurisdiction over such wells and gas committed to this Agreement, including but not limited to production, well test, completion and recompletion reports.

ARTICLE V

QUANTITY

1. Subject to the following provisions of this Agreement, commencing with the date of first delivery hereunder and continuing for a period of thirty-six (36) months, the daily contract quantity of gas hereunder shall be equal to one hundred-fifty (150) per cent of one million (1,000,000) cubic feet for each seven and three-tenths billion (7,300,000,000) cubic feet of reserves, as established under Article IV hereof. If the volume of committed reserves should either increase or decrease as a result of any redetermination made in accordance with Article IV hereof, or Seller is unable to maintain a daily delivery equal to the volumes requested by Buyer up to Seller's maximum delivery obligation, said daily contract quantity of gas shall be adjusted in accordance with the provisions of Section 1, Section 4 or Section 5 of this Article V, whichever is applicable.

2. Subject to the following provisions of this Agree-

fent, commencing at the end of the first thirty-six (36) month period and continuing during the

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remaining term of this Agreement, the daily contract quantity of gas hereunder shall be equal to one million (1,000,000) cubic feet for each seven and three-tenths billion (7,300,000,000) cubic feet of reserves, as established under Article IV hereof. If the volume of committed reserves should either increase or decrease as a result of any redetermination made in accordance with Article IV hereof, or Seller is unable to maintain a daily delivery equal to the volumes requested by Buyer up to Seller's maximum delivery obligation, said daily contract quantity of gas shall be adjusted in accordance with the provisions of Section 2, Section 4, or Section 5 of this Article V, whichever is applicable.

3. Buyer agrees that its take of gas hereunder during any one day shall never be less than sixty-five (65) per cent of the applicable daily contract quantity hereunder nor less than the volume of oil well gas tendered by Seller, and Seller agrees to deliver such quantity of gas per day as Buyer may from day to day elect to purchase, up to the maximum efficient rate of flow permitted by Seller's wells and facilities. Seller shall not be required to produce wells in excess of the maximum rate of flow fixed by law or regulatory body.

4. Should Seller fail on any day for any reason other than force majeure to deliver the daily volume requested by Buyer hereunder up to one hundred twenty-five (125) per cent of the daily contract quantity, then the daily contract quantity for that day shall be reduced to eighty

(80) per cent of the volume which Seller delivered on any such day, provided, that Seller shall be allowed a daily variation in deliveries of five (5) per cent of the daily quantity requested by Buyer, provided further, that the aggregate daily deliveries during each month are within one (1) per cent of the aggregate daily volumes requested by Buyer for such month.

5. In the event Seller fails for any reason other than force majeure to deliver the volumes requested by Buyer up to one hundred twenty-five (125) per cent of the daily contract quantity for five (5) consecutive days, then at

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Buyer's option, commencing with the first day of the month following the end of the fifth day of such failure to deliver and continuing thereafter until adjusted as hereinafter provided, the daily contract quantity shall be reduced to eighty (80) per cent of the average daily volume delivered during such five day period.

In the event the daily contract quantity is adjusted downward as provided in this Section 5, then Seller shall have the opportunity to restore all or a portion of the daily contract quantity determinable under Sections 1 or 2 of this Article V, whichever is applicable, in the following manner. In not more than seven (7) days after Seller has notified Buyer in writing that the inability to deliver gas hereunder has been remedied, Buyer shall, upon twenty-four (24) hours notice by Buyer to Seller, commence a five day test period during which time Seller will deliver and Buyer will purchase the maximum volumes deliverable by Seller, but not to exceed one hundred twenty-five (125) per cent of the maximum daily con-

tract quantity determinable under Sections 1 or 2 of this Article V, whichever is applicable. Commencing with the first day of the month following the last day of such test period, the daily contract quantity shall be deemed to be eighty (80) per cent of the average daily volume delivered by Seller during such five day test period.

If, as a result of such test the daily contract quantity is not restored, Seller shall not be permitted until three (3) months following the completion of such test to again request Buyer to conduct a subsequent test unless a reasonable amount of additional development or remedial work has been performed by Seller since that last test, in which case, evidence of such work shall be sufficient to permit a subsequent test.

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Upon receipt of notice from Seller that the inability to deliver has been remedied, Buyer may, in lieu of conducting such test, notify Seller that commencing with the first day of the month following receipt of said notice from Seller, the downward adjustment in daily contract quantity as provided in Section 5 hereof, shall no longer be effective.

6. If withdrawals by others from a reservoir or common source of supply containing reserves committed hereunder cause drainage of Seller's reserves, Buyer shall be obligated upon written notice from Seller to Buyer accompanied by sufficient proof of such drainage, to increase, within the limits of the physical and certificated capacity of its facilities, its receipt of gas therefrom to the extent necessary to equalize withdrawals and prevent such drainage. In the event such capacity of Buyer's

facilities is not sufficient to handle the increase in volume necessary to prevent drainage of Seller's reserves and Buyer does not desire to construct the necessary additional capacity, then Seller reserves the right to sell and dispose of such gas which Seller deems necessary in order to equalize its withdrawals with withdrawals of gas by others so as to prevent drainage of gas by others. Buyer agrees that in the event that such capacity of Buyer's facilities is not sufficient to handle the increase in volume necessary to prevent drainage of Seller's reserves and Seller does not elect to sell and dispose of gas in order to equalize its withdrawals with withdrawals of gas by others, then Buyer will include as a part of its next application to the Federal Power Commission for onshore or offshore Louisiana facilities a request for such authorization as may be necessary to accept and transport the quantities of gas necessary to prevent such drainage. Buyer shall not be obligated to purchase and receive in excess of its desired quantities if Seller without jeopardizing its leaseholds or

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reserves committed hereunder is able to decrease its withdrawals from other sources delivering gas hereunder and increase its withdrawals from such reservoir or source of supply to the extent necessary to prevent such drainage.

7. At the end of each accounting year the parties shall promptly determine (a) the annual contract quantity, (b) the cumulative annual contract quantity from the date of first delivery under this Agreement to the end of the accounting year in question, (c) the total quantity of gas taken under this Agreement by Buyer from the

date of first delivery hereunder to the end of the accounting year in question, and (d) the total quantity of gas previously paid for by Buyer but not taken, for which Buyer has not taken credit under the makeup provision hereinafter provided.

If the volume computed under (b) above exceeds the sums of the volumes computed under (c) and (d), Buyer shall within thirty (30) days after such computation pay Seller an amount determined by multiplying such excess volume by the price per Mcf applicable at the end of the accounting year in question. If in any accounting year during the first five accounting year period following an accounting year for which Buyer paid Seller for gas not taken, Buyer takes gas in excess of the annual contract quantity, Buyer shall deduct, as recoupment for gas previously paid for but not taken, from future payments for gas delivered under this Agreement. The deduction for recoupment volumes shall apply to the first volumes of gas in the earliest accounting year in which Buyer is entitled to receive recoupment and shall continue in order by accounting years until the total recoupment volumes of prepaid gas equals the lesser of the volume of gas taken in excess of the annual contract quantity or the total recoupment Buyer is entitled to receive. The amount of the payments to be deducted shall be computed on the same basis for which Buyer prepaid for an equivalent volume of gas.

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8. Notwithstanding anything to the contrary contained herein, on any day when deliveries or takes are affected by force majeure and the volumes delivered are less than

the applicable daily contract quantity, the daily contract quantity hereunder, or portion thereof, shall be deemed to be the actual volume delivered and purchased during the effective period of such force majeure.

9. Deliveries of gas by Seller to Buyer hereunder will be at more than one point thus from time to time as required Buyer and Seller, after giving consideration to the ability of wells to produce and facilities to handle gas, will agree as to the volume of gas Seller can deliver and Buyer can transport from each point of delivery.

ARTICLE VI

INITIAL DELIVERY AND TERM

1. After Buyer and Seller notify each other that their respective Certificates of Public Convenience and Necessity or such other authorizations issued by the Federal Power Commission are acceptable, both parties agree to commence and proceed with reasonable diligence to construct the lines and facilities required to deliver and receive gas under this Agreement so that the facilities shall be completed and placed in operation by November 1, 1968, or four (4) months after the notification referred to above, whichever is later, and commencing on November 1, 1968, or four (4) months after such notification, whichever is later, Buyer shall be obligated to take or pay for gas hereunder.

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2. This Agreement shall become effective as of the date hereof and shall remain effective for a period of twenty (20) years from the date of initial delivery hereunder and

from year to year thereafter until cancelled by written notice given by either party to the other not less than six (6) months prior to the end of such twenty (20) year period or any subsequent anniversary date thereof. If Seller uses gas committed hereunder for repressuring or secondary recovery operations and during such time the daily contract quantity is adjusted downwards in accordance with the provisions of Sections 4 and 5 of Article V hereof, the primary term of this Agreement shall be extended for a period of time sufficient for Buyer to purchase a volume of gas equivalent to that volume which Buyer would have been entitled to receive if the repressuring or secondary recovery operation had not been conducted.

ARTICLE VII

QUALITY OF GAS

1. All gas delivered by Seller under the terms of this Agreement shall conform to the following specifications:

(a) The gas shall be commercially free from dust, gum, gumforming constituents, gasoline and other liquids and solids which may become separated from the gas.

(b) The gas shall not at any time have an oxygen content in excess of one(1) per cent by volume and Seller shall make every reasonable effort to keep the gas free of oxygen.

(c) The gas shall not contain more than one grain of hydrogen sulphide per one hundred (100) cubic feet. This purity requirement shall be considered as satisfied if a strip of white filter paper recently moistened

with a solution of one hundred (100) grains of lead accetate in one hundred (100) cc. of water be exposed to the gas for one and one-half (1½) minutes in an apparatus previously purged through which gas is flowing at a rate of approximately five (5) cubic feet per hour, the gas not impinging from a jet upon the test paper and after this exposure the test paper is not found distinctly darker than a second paper freshly moistened with the solution and not exposed to the gas. If the gas does not meet the purity requirements determined in the above test, the hydrogen sulphide content shall be determined by a cadmium sulphide quantitative test.

(d) The gas shall not contain more than twenty (20) grains of total sulphur (including the sulphur in any hydrogen sulphide and mercaptans) per one hundred (100) cubic feet.

(e) The gas shall have a total heating value per cubic foot of not less than one thousand (1,000) British thermal units. The term "total heating value per cubic foot" shall mean the number of British thermal units, produced by the combustion at constant pressure, of the amount of gas, saturated with water vapor, which would occupy a volume of one (1) cubic foot at a temperature of sixty (60) degrees Fahrenheit and under pressure equivalent to that of thirty (30) inches of mercury at thirty-two (32) degrees Fahrenheit and under the standard gravitational force with air of the same temperature and pressure as the gas, when the products of combustion are cooled to the initial temperature of gas in air and when the water formed by combustion is condensed to a liquid stage.

(f) The water content of the gas shall not be more than six (6) pounds per million cubic feet of gas measured at a pressure of 14.7 pounds per square inch absolute and sixty (60) degrees Fahrenheit temperature; provided, however, so long as the gas hereunder is processed subject to the provisions of Article III, Section 3 hereof, Seller shall be permitted to deliver gas at

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the points of delivery hereunder containing up to seven (7) pounds of water per million cubic feet of gas measured at a pressure of 14.7 pounds per square inch absolute and sixty (60) degrees Fahrenheit temperature.

(g) The gas shall be delivered at a temperature not in excess of one hundred thirty (130) degrees Fahrenheit.

2. Should the heating value of the gas be found to average less than one thousand (1,000) British thermal units per cubic foot during any given month, Buyer shall have the option to suspend the portion of the deliveries hereunder causing such condition without obligation hereunder, or to reduce the total amount payable as the purchase price to be paid for gas by an amount determined by multiplying such total amount ordinarily payable by a fraction whose numerator is the deficiency of British thermal units below one thousand (1,000) and its denominator one thousand (1,000). Nothing herein contained shall be construed as to allow Seller to reduce the heating value of the gas below one thousand (1,000) British thermal units by processing methods.

3. Should the gas offered for sale to Buyer fail at any time to conform to any of the specifications of this Article,

Buyer shall notify Seller of any such failure and Seller shall make a diligent effort to correct such failure so as to deliver gas conforming to the above specifications. If Seller is unable to deliver gas conforming to the above specifications by treatment consistent with prudent operations and by means which are economically feasible in Seller's opinion, Buyer may at its option suspend purchase of all or a portion of such gas, and it shall be relieved of its obligations hereunder, for the duration of such time as the gas does not meet such specifications. Failure of Buyer to accept gas not meeting specifications for a period of thirty (30) consecutive days, where such failure is not occasioned by default of Seller, shall give Seller or Buyer the right to cancel and terminate this Agreement upon ten (10) days' written notice, only insofar as it relates to the reserves relative to the gas not meeting such specifcations.

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year from the rendition thereof.

ARTICLE XIV

REGULATION

1. This Agreement, insofar as it is affected thereby, shall be subject to all applicable and valid laws, ordinances, rules and regulations of Federal, State, Parochial and Municipal Governments and authorities having jurisdiction, and in the event this Agreement or any provisions hereof shall be found contrary to, or in conflict with any such law, ordinance or regulation, the latter shall be deemed to control.

ARTICLE XV

WARRANTY

1. Seller warrants generally the title to all gas delivered hereunder and agrees to indemnify Buyer from all suits, actions, debts, acts, damages, costs, losses and expenses arising from or out of adverse claims of any or all persons to said gas and to royalties or charges thereon incurred prior to the delivery thereof.

ARTICLE XVI

LIABILITY

1. As between the parties hereto, Seller shall be in control and possession of the gas deliverable hereunder and responsible for any damage or injury thereby until same shall have been delivered to Buyer at the points of delivery, after which delivery Buyer shall be in exclusive control and possession thereof and responsible for any injury or damage thereby.

ARTICLE XVII

FORCE MAJEURE

1. If either Buyer or Seller is rendered unable, wholly or in part, by force majeure or any other cause of any kind not reasonably within

such party's control to perform or comply with any obligation or condition of this Agreement, upon giving notice and reasonably full particulars to the other party such obligation or condition shall be suspended during the continuance of the inability so caused and such party shall be relieved of liability and shall suffer no prejudice

for failure to perform the same during such period; provided, obligations to make payments then due for gas delivered hereunder shall not be suspended and the cause of suspension (other than strikes or lockouts) shall be remedied so far as possible with reasonable dispatch if, in the sole discretion of the party unable to perform its obligations, it is economically feasible to remedy such cause of suspension. Settlement of strikes and lockouts shall be wholly within the discretion of the party having the difficulty. The term "force majeure" shall include, without limitation by the following enumeration, acts of God and the public enemy, the elements, fire, accidents, breakdowns, shut-downs for purposes of necessary repairs, relocation, or construction of facilities, breakage or accident to machinery or lines of pipe, the necessity of making repairs or alterations to machinery or lines or pipe, inability to obtain materials, supplies, permits, or labor to perform or comply with any obligation or condition of this Agreement, strikes and any other industrial, civil or public disturbances, any act or omission (including failure to take gas) of a purchaser of gas from Buyer which is excused by any event or occurrence of the character herein defined as constituting force majeure, and any laws, orders, rules, regulations, acts or restraints of any government or govenmental body or authority, civil or military.

ARTICLE XVIII

ASSIGNMENT

The terms, covenants, and conditions hereof shall be binding on the parties hereto, their successors and assigns.

It is provided, however, that no assignment of this Agreement shall

APPENDIX A
SCHEDULE 3

GRAND ISLE BLOCK 76
CONTRACT WITH FLORIDA GAS

Factors affecting gas delivery and take obligations:

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GAS PURCHASE AND SALE CONTRACT

THIS CONTRACT, made and entered into as of August 21, 1975, by and between SHELL OIL COMPANY, herein called "Seller", and FLORIDA GAS TRANSMISSION COMPANY, herein called "Buyer";

WITNESSETH;

WHEREAS, Seller desires to sell and deliver to Buyer and Buyer desires to purchase and receive from Seller natural gas, in the quantities and upon the terms and conditions hereinafter set forth, from the reservoirs hereinafter described.

NOW THEREFORE, for and in consideration of the premises and the mutual benefits and covenants herein contained, Seller and Buyer hereby covenant and agree as follows:

ARTICLE I — *DEFINITIONS*

1.1 Except where the context otherwise indicates another different meaning or intent, the following words and terms as used herein shall be construed to have the meanings indicated:

(a) The word "day" shall mean a period of twenty-four (24) consecutive hours beginning at 7:00 a.m. (local time). The date of a day shall be that of its beginning.

(b) The word "month" shall mean a period beginning at 7:00 a.m. (local time) on the first day of a

calendar month and ending at 7:00 a.m. (local time) on the first day of the next succeeding calendar month.

(c) "Contract Year" shall mean a calendar year except that the first Contract Year shall mean a period beginning on January 1, 1976, or on the date of first delivery of gas hereunder, whichever is the earlier date, and continuing to the end of the last day of the calendar year during which such date occurred.

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(d) "Oil Well Gas" shall mean gas produced from a well classified as an oil well under the laws or rulings of the regulatory body having jurisdiction of production allowables of the well, and, in the absence of such classification, such term shall mean gas which is associated or blended with crude oil at the time of its production.

(e) "Gas Well Gas" shall mean gas other than Oil Well Gas.

(f) The word "gas" shall mean both Oil Well Gas and Gas Well Gas.

(g) "Mcf" shall mean one thousand (1,000) cubic feet of gas.

(h) The term "psig" shall mean pounds per square inch gauge.

(i) "Btu" shall mean British thermal units.

(j) "Delivery Capacity" shall mean the maximum daily

quantity of Gas Well Gas Which, in the course of prudent operation (as determined in the sole discretion of Seller, exercised in good faith), can be delivered to Buyer from Seller's interest in the properties covered hereunder.

ARTICLE II — *GAS SUBJECT TO CONTRACT*

2.1 Subject to all of the terms, conditions, and limitations herein set forth, Seller agrees to sell and deliver or cause to be delivered to Buyer, and Buyer agrees to purchase and receive from Seller, during the term hereof, gas attributable to twenty-five percent (25%) of Seller's interest in gas to be produced from the reservoirs identified or described below, but only to the extent that such reservoirs underlie the acreage outlined on Exhibit "A":

The Nos. 9, 10 and 12 sands, the "A" series sands, the B_2 sand, the "C" series sands and the "D" series sands existing within the stratigraphic interval between electric log measured depths of 3200 feet and 9450 feet in OCS-G 2161 Well No. 1.

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ARTICLE III — *RESERVATIONS*

3.1 Seller expressly reserves unto itself, its successors and assigns, the following rights with respect to gas subject to this Contract and a quantity of gas sufficient to satisfy such rights:

(a) To operate Seller's leaseholds, lands and/or interests therein, free from any control by Buyer, in such manner as Seller deems advisable, including

the right (but never the obligation) to driil new wells, to repair and rework old wells, renew and extend (in whole or in part) any lease, to abandon any well or surrender any lease (in whole or in part) for any reason, and to abandon, modify, extend or dispose of any facilities owned or installed (in whole or in part) by Seller.

(b) To deliver gas to lessors in quantities sufficient to fulfill Seller's lease obligations.

(c) To use gas for the development and operation of the properties subject hereto and properties which Seller operates for itself and others in the vicinity of the properties subject hereto, including (but not limited to) the use of gas for fuel, drilling (including gas drilling), deepening, reworking, compressing, gas lifting, processing and treating, and to use gas on the properties subject hereto for cycling, repressuring or other supplemental recovery operations.

(d) To sell gas to others for drilling (including gas drilling) in the vicinity of Seller's properties which are subject hereto.

(e) To process gas as hereinafter provided.

(f) To form or participate in formation of any unit or units, including (but not limited to) any field-wide unit or units, which may include all or part of the reservoirs subject hereto; provided, that this Contract shall apply to the interest of Seller in such unit or units to the extent that such interest is attributable to the reservoirs subject hereto.

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ARTICLE IV — *QUANTITIES*

4.1 Commencing on January 1, 1976, or on the date of first delivery of gas hereunder, whichever is the earlier date, and continuing throughout the term hereof, Seller shall sell and deliver to Buyer and Buyer shall purchase and take from Seller, during each day, all of the Oil Well Gas made available for sale by Seller from the reservoirs subject hereto. If, for any reason, Buyer fails to take Oil Well Gas tendered to it by Seller, Buyer shall pay Seller therefor as if such gas had been actually taken by Buyer without any right to make up Oil Well Gas; provided, that Buyer's failure to take Oil Well Gas for reasons of force majeure shall be excused from and after the date of first delivery hereunder.

4.2 Commencing on January 1, 1976, or on the date of first delivery of gas hereunder, whichever is the earlier date, Seller shall sell and deliver to Buyer and Buyer shall purchase and take from Seller

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hereunder or, if available and not taken, Buyer shall pay Seller for, during each Contract Year, a daily contract quantity of Gas Well Gas equal to ninety percent (90%) of Delivery Capacity. Delivery Capacity shall be deemed to be sixteen thousand six hundred seventy (16,670) Mcf until a determination of Delivery Capacity has been made. The daily contract quantity provided for in this paragraph shall be subject to change or adjustment in accordance with the provisions of Paragraph 4.3. Buyer shall give Seller reasonable notice of any change in the daily quan-

tity Gas Well Gas which Buyer elects to take hereunder. Seller shall change the rate of Gas Well Gas to conform as closely as practicable to each such notice.

4.3 If, at any time during the term of this Contract, Buyer purchases or agrees to purchase from properties within the States of Texas or Louisiana (including the federal offshore), from any party, daily quantities of Gas Well Gas equal to a percentage of delivery capacity greater than that provided in Paragraph 4.2, Buyer shall promptly notify Seller of such purchase. Seller may then, by notice to Buyer, elect to have the daily contract quantity hereunder determined by use of such higher percentage, effective as of the first day of the month next following Buyer's receipt of such notice.

4.4 If on any day, for any reason other than force majeure, Seller fails to deliver the volume of Gas Well Gas requested hereunder up to Delivery Capacity, then the daily contract quantity for that day shall be reduced to the volume of Gas Well Gas which Seller delivered on that day.

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4.5 If for thirty (30) consecutive days, for any reason other than force majeure, Seller fails to deliver the volumes of Gas Well Gas requested by Buyer up to Delivery Capacity, then, commencing on the first day of the month following the end of the thirtieth (30th) day of such failure to deliver and continuing thereafter until further adjusted, the daily contract quantity shall be reduced to ninety percent (90%) of the average volume of Gas Well Gas delivered during such thirty (30) day period.

4.6 Delivery Capacity shall be determined in the following manner at the request of either party, provided, however, such requests shall not be made more often than once each three (3) months unless Seller has performed a reasonable amount of additional development or remedial work since the last determination: Within seven (7) days after Buyer has received Seller's request, Buyer shall, with twenty-four (24) hours' notice to Seller, commence a seventy-two (72) hour test period during which Seller shall deliver and Buyer shall take the maximum volumes of Gas Well Gas deliverable by Seller. Commencing on the day following the last day of such test period, the daily contract quantity shall be deemed to be ninety percent (90%) of the average daily volume of Gas Well Gas delivered by Seller during such seventy-two (72) hour period.

4.7 Buyer agrees to purchase and take during each day after deliveries have commenced hereunder a quantity of Gas Well Gas equal to at least seventy-five percent (75%) of the daily contract quantity in effect. Buyer further agrees to purchase and take during each month after deliveries have commenced hereunder a quantity of Gas Well Gas equal to at least ninety

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percent (90%) of the sum of the daily contract quantities in effect during such month.

4.8 If, for any reason other than force majeure, Buyer shall fail to take during any Contract Year a quantity of Gas Well Gas equal to the sum of the daily contract quantities in effect for such year, Buyer shall, within sixty

(60) days after the end of such year, pay Seller for a quantity of Gas Well Gas equal to the difference between such sum and the quantity taken during such year. The price to be paid for such gas not taken shall be the price in effect at the end of the Contract Year during which the gas was not taken.

4.9 If Buyer pays for a quantity of Gas Well Gas not received by it, Buyer shall thereafter be entitled to receive, without payment, such quantity of Gas Well Gas in any one or more of the five (5) Contract Years next following the Contract Year in which Buyer failed to take such Gas Well Gas and in which Buyer shall have first taken the applicable sum of the daily contract quantities in effect for each such Contract Year; provided, however, (a) that this provision shall not operate to extend the term of this Contract, and (b) that Buyer shall pay any increase in price between that upon which payments were made and that applicable at the time of taking. If, at the end of such five (5) Contract Years, Buyer has not made up such quantity of Gas Well Gas, Buyer shall have no further right to receive such quantity without payment, and Seller shall have no liability to Buyer on account of Buyer's failure to have made up such quantity.

4.10 Buyer and Seller shall make such nominations and/or forecasts for Gas Well Gas allowables as are required to permit Seller to produce and

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Buyer to receive the quantities of Gas Well Gas which Buyer is obligated to take or pay for whether taken or not hereunder. Buyer's failure to make such nominations

when required shall excuse Seller's inability to deliver gas because of the lack of a proper allowable, but such excused inability to deliver shall not reduce Buyer's obligation to take or pay for the daily contract quantity of Gas Well Gas then in effect pursuant to the foregoing provisions of this Article.

4.11 Buyer agrees that its takes of Gas Well Gas from Seller's wells will be at least ratable with takes, by Buyer or others, of Gas Well Gas from each of the reservoirs subject to this Contract.

4.12 If on January 1, 1976, Seller is capable of commencing deliveries but Buyer is unable to commence the taking of gas hereunder, then, effective as of such date, Buyer shall make monthly payments to Seller as though deliveries had commenced. For each month for which payment is due under this paragraph, Buyer shall pay Seller on or before the tenth (10th) day of the following month at the price in effect for such month pursuant to Article V hereof. Such payment shall be the total of (a) an amount calculated by multiplying such price by the estimated volumes of Oil Well Gas produced and flared or vented in such month and (b) an amount calculated by multiplying such price by the sum of the daily contract quantities of Gas Well Gas for such month as provided for in Paragraph 4.2 hereof. Monthly payments made by Buyer pursuant to this paragraph shall continue until the end of the month during which actual deliveries of gas commence hereunder. The force majeure provisions of Article XVII hereof shall not be applicable to excuse the payments required under this Paragraph.

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4.13 If Buyer makes payments for Gas Well Gas pursuant to Paragraph 4.12, Buyer shall have the right to make up the volumes of Gas Well Gas pursuant to Paragraph 4.9. If this Contract is terminated pursuant to the provisions of Article XIII hereof, payments made by Buyer pursuant to Paragraph 4.12 for Gas Well Gas not taken shall be promptly refunded, without interest, by Seller to Buyer.

4.14 If, in any month, Seller is not permitted by any governmental authority to produce any oil well solely because of Buyer's failure to provide a market for Oil Well Gas, and if Buyer's said failure is not excused for reason of force majeure from and after the date of first delivery hereunder, then the payments to be made by Buyer to Seller for Oil Well Gas pursuant to Paragraphs 4.1 or 4.12, whichever is applicable, shall be calculated by using a volume of 6,000 Mcf times the number of completed oil wells which Seller was not permitted to produce in the month.

4.15 Nothing in this Contract shall require Seller to deliver on any day a quantity of Gas Well Gas greater than one hundred and ten percent (110%) of the daily contract quantity in effect hereunder from time to time.

4.16 Seller's obligations hereunder are subject to the ability of Seller's wells to produce without waste and in accordance with prudent oil and gas field practice. Seller shall not be required to produce any well at a rate in excess of a maximum rate of flow fixed by law or regulatory body or in excess of the maximum efficient rate of flow of such well.

ARTICLE V — *PRICE*

5.1 Subject to the further provisions of this Article, Buyer agrees to pay Seller for each Mcf of gas delivered or for which payment is

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of any injuries, claims, liabilities or damages occurring while the gas is in the former's possession.

ARTICLE VIII — *PRESSURES*

8.1 Except as otherwise provided in this Article, Seller shall deliver gas hereunder at a pressure sufficient to permit the gas to enter Buyer's facilities, but Buyer shall never operate its facilities at a working pressure in excess of 1050 psig, nor shall Seller ever be obligated to deliver gas at a pressure in excess of 1050 psig. If Buyer does not operate the pipeline facilities used to take gas hereunder, and if Buyer is required by the operator of such facilities to have gas delivered at a pressure in excess of 1050 psig, Seller agrees to deliver gas at the required pressure, up to 1275 psig. If Seller compresses gas to so deliver at a pressure in excess of 1050 psig, Buyer agrees to pay Seller a fee of seven-tenths cents (0.7¢) per Mcf of gas compressed and further agrees to furnish the fuel used for such compression, free of cost to Seller. Seller may discontinue compression at any time Seller deems it uneconomic.

8.2 Either party may, but neither shall be obligated to, install and operate compression facilities for the delivery of gas hereunder, it being understood that either party may discontinue the operation of such facilities if,

in the sole judgment of such party, such operation is or becomes uneconomical.

8.3 If any well covered by this Contract is or becomes incapable of delivering gas against the working pressures maintained in Buyer's line, and if neither party elects to install a compressor, then Buyer shall, upon request from Seller, release such well and the gas to be produced therefrom from the

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terms and provisions of this Contract.

ARTICLE IX — *MEASUREMENT*

9.1 A "cubic foot of gas" for all purposes hereunder, except where specifically provided to the contrary, is the amount of gas necessary to fill a cubic foot of space at a base pressure of fifteen and twenty-five thousandths (15.025) pounds per square inch absolute and at a base temperature of sixty degrees (60°) Fahrenheit.

9.2 The atmospheric pressure at each Delivery Point shall be assumed to be fourteen and seven tenths (14.7) pounds per square inch.

9.3 The gas delivered hereunder shall be measured with orifice meters constructed and installed, and whose computations of volume are made, in accordance with the provision of Gas Measurement Committee Report No. 3 of the American Gas Association, as revised and reprinted September, 1969, with any subsequent amendments or revisions which may be mutually acceptable to Seller and Buyer.

9.4 The temperature of the gas shall be determined by a continuously recording thermometer so installed that it may record the temperature of the gas flowing through the meters. The average of the record, to the nearest one degree (1°) Fahrenheit, obtained while gas is being delivered shall be the applicable flowing gas temperature for the period under consideration.

9.5 The specific gravity of the gas shall be determined by spot tests made with an Edwards or other standard type specific gravity instrument, or by a continuously recording gravitometer so installed that it may record the specific gravity of the gas flowing through the meters. If the spot test method is used, the tests shall be made quarterly or at such other interval as

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10.5 The charts and records from Buyer's measuring equipment shall remain the property of Buyer and shall be kept by Buyer on file for a period of not less than three (3) years. At any time within such period, Buyer shall, upon request of Seller, submit to Seller records and charts from its measuring equipment, together with calculations therefrom, for Seller's inspection and verification, subject to return by Seller within thirty (30) days from receipt therefor.

ARTICLE XI — *QUALITY*

11.1 The gas delivered to Buyer hereunder shall meet the following specifications, which herein are collectively called "Quality Specifications":

(a) *Water.* The gas shall in no event have a water content in excess of seven (7) pounds of water per one million (1,000,000) cubic feet of gas.

(b) *Hydrogen Sulphide.* The gas shall not contain more than one (1) grain of hydrogen sulphide per one hundred (100) cubic feet.

(c) *Total Sulphur.* The gas shall not contain more than twenty (20) grains of total sulphur per one hundred (100) cubic feet of gas.

(d) *Temperature.* The gas shall not have a temperature of more than one hundred and twenty degrees (120°) Fahrenheit.

(e) *Carbon Dioxide.* The gas shall not contain in excess of three percent (3%) by volume of carbon dioxide.

(f) *Oxygen.* The gas shall not contain in excess of three percent (3%) by volume of oxygen.

(g) *Objectionable Liquids and Solids.* The gas shall (i) be free of objectionable liquids and solids and (ii) be commercially free from dust, gums, gum-forming constituents, or other liquid or solid matter which might become separated from the gas in the course of transportation through pipelines.

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(h) *Heating Value.* The gas shall have a gross heating value of at least one thousand (1,000) Btu's per cubic foot. The gross heating value of the gas shall be determined by adjusting the heating value obtained from a mutually acceptable test of

one cubic foot of gas at a temperature of sixty degrees (60°) Fahrenheit and at a pressure of fifteen and twenty-five thousandths (15.025) pounds per square inch absolute to compensate for differences between the water vapor content under testing conditions and the average water vapor content of the gas being delivered. The gross heating value so determined shall be expressed in Btu for all purposes hereunder. Tests for such determination of heating value shall be conducted at least once each month, and the result of any test shall be used until the results of a subsequent test shall be known.

11.2 All tests required by this Article shall be conducted by Buyer and at Buyer's expense and shall be made as often as reasonably required by approved standard methods in general use by the gas industry. Buyer shall give Seller reasonable notice of all such tests in order that Seller may have its representatives present, if Seller so desires.

11.3 If the gas subject hereto when produced fails to meet the Quality Specifications, Buyer shall have to waive such failure and to continue to receive such gas. If Buyer refuses to receive such gas and Seller does not elect to process the gas so as to cause the same to meet the Quality Specifications because Seller does not deem it economically feasible to do so, then Seller shall stop the delivery of gas from the well or wells which are producing the gas which is causing the gas tendered for delivery to fail to meet such Quality Specifications. At the election of Seller, the well or wells from which Buyer so refuses to receive the production and the gas to be pro-

duced therefrom shall be released from the terms and provisions of this Contract.

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cost, damage or expense resulting or arising from Seller's failure to install, maintain and inspect such controls and devices in accordance with such laws, regulations and orders, or arising from the failure of any such control or device.

12.4 Buyer covenants and agrees to fully protect, indemnify and hold Seller, its successors and assigns, harmless from and against each and every claim, demand, or cause of action, and any liability, cost, expense, damage or loss in connection therewith which may be made on account of personal injury or death, or on account of property damage, resulting from or arising out of the installation, presence, maintenance and operation of Buyer's facilities on Seller's properties, platforms, lands and leases, except for those damages or losses caused by Seller's negligence.

ARTICLE XIII — *REGULATORY AUTHORITIES*

13.1 This Contract, insofar as it is affected thereby, shall be subject to all present and future valid and applicable laws and to the valid and applicable present and future rules, regulations or orders of any regulatory agency or authority.

13.2 Seller and Buyer agree to seek promptly any governmental permits, licenses and authorizations which they individually deem necessary to carry out their re-

spective obligations under this Contract. Seller and Buyer also agree to file promptly with the Federal Power Commission for such Certificates of Public Convenience and Necessity authorizing the performance by each party of its obligations under this Contract as they individually deem necessary, but Seller shall not be required to apply for a temporary

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certificate if, in the exercise of its sole discretion, it believes a permanent certificate to be the only satisfactory form of authorization. Upon the issuance of a certificate, the party receiving such certificate agrees promptly to furnish the other party with a copy of the certificate issued to it and to notify the other in writing of its acceptance of such certificate or to furnish such party with a copy of its rejection notice sent to the Federal Power Commission.

13.3 Immediately upon the acceptance by Seller and Buyer of all such governmental authorizations as may be required for each party to perform its respective obligations under this Contract, and such authorizations becoming final and no longer subject to judicial review, Buyer and Seller shall commence such action as may be required for the performance of this Contract and diligently prosecute same to completion.

13.4 If Seller has not obtained a Certificate of Public Convenience and Necessity from the Federal Power Commission, if required, which is satisfactory to Seller within six (6) months after the date of Seller's application therefor, then either party may terminate this Contract at any time after such period by giving written notice of such termination to the other party. If Buyer has not obtained

a Certificate of Public Convenience and Necessity from the Federal Power Commission, if required, which is satisfactory to Buyer within twelve (12) months after the date of Buyer's application therefor, then either party may terminate this Contract at any time after such period by giving written notice of such termination to the other party. If this Contract is cancelled under the provisions of this paragraph, neither party

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shall be under any obligation, or liable for any damages, to the other by reason thereof, except for payments to be refunded pursuant to Paragraph 4.13.

ARTICLE XIV — *PROCESSING*

14.1 Seller reserves the right at any time to process the gas to be delivered hereunder for the extraction of substances contained therein other than methane (except such methane necessarily removed in such processing). Seller may process gas hereunder individually, jointly with others, or by assignment of such right to one or more parties. Seller reserves the right to process gas hereunder at any mutually agreeable point on Buyer's pipeline system downstream from any Delivery Point. Buyer agrees it will not permit any other party to process its gas on Buyer's pipeline system at a point on such system or deliver processed gas into such system upstream of such mutually agreeable point. All substances extracted from gas in the processing thereof by Seller shall be owned by Seller (and other plant owners and plant suppliers, if any), and Buyer shall not acquire any right, title or interest in any substances so extracted.

14.2 If Seller elects to process gas at a point on Buyer's pipeline system, the remaining paragraphs of this Article shall apply to such processing and the facilities used to process gas shall be referred to herein as the "Plant".

14.3 Buyer agrees to install, at no cost to Seller, main line block valves and bypasses, Plant inlet and outlet valves and all other facilities necessary to permit the tie-in and operation of the Plant and the safe and satisfactory operation of Buyer's pipeline system, including but not limited

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to, measuring facilities, blowdown connections and scraper traps.

14.4 Buyer agrees to deliver to the Plant, at no cost to Seller (except that Seller shall pay such charges imposed by reason of any valid and applicable law, order or rule of any governmental authority having jurisdiction), a volume of gas containing the same number of gallons of propane and heavier hydrocarbons as are delivered to Buyer by Seller at the Delivery Points. If gas other than gas delivered hereunder is being transported through Buyer's facilities at the Plant, Seller shall have the right to process a quantity of such other gas as contains a quantity of propane and heavier hydrocarbons equal to the propane and heavier hydrocarbons contained in the gas delivered at the Delivery Points hereunder. If Seller is processing gas at the Plant and there is gas in Buyer's pipeline system upstream of the Plant the processing rights for which are owned by Buyer, then Buyer shall also deliver

a proportionate part of such gas to the Plant, and Buyer hereby grants to Seller all its right, title and interest in all substances extracted at the Plant from such proportionate part of such gas. The volume of such proportionate part of such gas shall be in the ratio that volumes of gas delivered by Seller into Buyer's pipeline system during the preceding month bears to the volume of gas delivered by all other parties into said system during such month.

14.5 All gas delivered to the Plant shall be delivered at operating pressures between 700 and 1000 psig and at temperatures not in excess of 100°F.

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14.6 Seller shall deliver to Buyer all volumes of residue gas remaining after processing the gas delivered hereunder in the Plant. Such residue gas shall conform to the Quality Specifications herein provided except that the temperature shall be as hereinafter further provided. Seller shall be obligated to provide such compression as may be necessary to make up any pressure drop in excess of a drop of 35 pounds per square inch which may occur in the Plant. If recompression is required at the Plant, the temperature of the residue gas shall not be in excess of ten degrees Fahrenheit (10°F) above the temperature of the gas delivered to the Plant nor more than one hundred degrees Fahrenheit (100°F).

14.7 Gas processed in the Plant and the residue gas therefrom shall be delivered, redelivered, measured and accounted for in accordance with procedures mutually satisfactory to Buyer and Seller.

14.8 Seller shall account to Buyer for the Plant volume

reduction, which shall include Plant fuel, shrinkage and incidental losses in the Plant. The Plant volume reduction shall not exceed ten percent (10%) of the volume of Seller's gas processed in the Plant. Seller shall also account to Buyer for the difference in heating value between the gas delivered to the Plant and the residue gas redelivered to Buyer to the extent that Seller has been compensated for such heating value. At Seller's option, such accounting shall be by one or more of the following methods; provided, that no such method shall inflict any cost on Buyer by reason of the Plant volume reduction or the reduction in heating value at the Plant:

(a) By payment to Buyer for the purchase cost of the Plant volume reduction as adjusted for the difference in heating value.

(b) By reducing Buyer's payments hereunder by the purchase cost of the Plant volume reduction as adjusted for the difference in heating value.

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(c) By Seller's restoration of the Plant volume reduction by delivery to Buyer from other sources of gas meeting the Quality Specifications hereof at the Plant and/or at a point on Buyer's pipeline system downstream of the Plant.

14.9 Buyer reserves the right to use such gas from Buyer's pipeline upstream of the Plant as is required for the reasonable and prudent operation of Buyer's facilities and the right to make nominal sales of gas to others for drilling fuel, lease operations, pumping stations and other

similar purposes. It is also recognized that some losses of gas volumes may occur in the operation of such facilities. Seller's proportionate part of such gas so used or lost shall be deducted from the quantity of gas otherwise deliverable to Seller for processing hereunder.

14.10 All Plant overations conducted by or on behalf of Seller shall be at its sole cost, risk and expense, and, as between Seller and Buyer, Seller shall be responsible for the safe handling of the gas while it is in Seller's custody (or the custody of another on Seller's behalf) for processing.

ARTICLE XV — *ACCOUNTING*

15.1 Buyer shall furnish Seller, on or before the fifth (5th) day of each month, a statement showing the total quantity of gas received by Buyer during the preceding month at each Delivery Point hereunder. If the allocation statement referred to in Paragraph 15.2 of this Article XV is not then applicable to a Delivery Point, Buyer shall make payment to such address as Seller may designate from time to time, by check on or before the twenty-fifth (25th) day of the month following the month in which gas was delivered to Buyer at such Delivery Point.

15.2 During any period Buyer purchases gas at any Delivery Point from Seller and from other parties, Seller shall furnish or cause to be furnished to

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to may request the American Arbitration Association to select the arbitrator or arbitrators to complete the

board of three. After three arbitrators are appointed pursuant to the foregoing provisions of this Paragraph 16.1, they shall meet, hear the parties with respect to the matter to be arbitrated, and issue a decision thereon. Any decision agreed to in writing by at least two of the said arbitrators shall be final and binding on the parties hereto.

16.2 All arbitrators appointed hereunder shall be qualified by training and experience to decide the matter to be arbitrated. Buyer and Seller shall each bear its own costs of arbitration hereunder, including the costs of appointing its own arbitrator. The fees and expenses of all arbitrators not appointed by either Buyer or Seller shall be borne equally by the parties.

ARTICLE XVII — *FORCE MAJEURE*

17.1 If either party is unable, wholly or in part, by force majeure to carry out its obligations (except financial obligations) under this Contract, it is agreed that, on such party's giving notice and reasonable full particulars of such force majeure in writing or by telegraph to the other party within a reasonable time after the occurrence of the cause relied on, then the obligations of the party giving such notice, so far as they are affected by such force majeure, shall be suspended during the continuance of any inability so caused, but for no longer period, and such cause shall so far as possible be remedied with all reasonable dispatch. The term "force majeure," as employed herein, shall mean acts of God, strikes, lockouts or other industrial disturbances, acts

of the public enemy, wars, blockades, insurrections, riots, epidemics, landslides, lightning, earthquakes, fires, storms, floods, high water, washouts, arrests and restraints of government and people, civil disturbances, explosions, breakage or accident to machinery or lines of pipe, freezing of wells or lines of pipe, partial or entire failure of wells, and any other causes, whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming suspension; such term shall likewise include (a) in those instances where any party hereto is required to obtain servitudes, rights of way grants, permits or licenses to enable such party to fulfill its obligations hereunder, the inability of such party to acquire, or the delays on the part of such party in acquiring, at reasonable cost and after the exercise of reasonable diligence, such servitudes, rights of way grants, permits or licenses, and (b) in those instances where any party hereto is required to furnish materials and supplies for the purpose of constructing or maintaining facilities or is required to secure permits or permissions from any governmental agency to enable such party to fulfill its obligations hereunder, the inability of such party to acquire, or the delays on the part of such party in acquiring, at reasonable cost and after the exercise of reasonable diligence, such materials and supplies, permits and permissions.

17.2 It is understood and agreed that the settlement of strikes or lockouts shall be entirely within the discretion of the party having the difficulty, and that the above requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of

strikes or lockouts by acceding to the demands of an opposing party when such course is inadvisable in the discretion of the party having the difficulty.

ARTICLE XVIII—*WARRANTY*

18.1 Seller hereby warrants title to the gas delivered hereunder, the right to sell the same, and that it is free from all liens and adverse claims, and agrees, if notified thereof by Buyer, to indemnify Buyer against lawsuits, actions, debts, accounts, damages, costs (including attorneys' fees), losses and expenses arising from or out of any adverse legal claims of any and all persons to, or against, said gas prior to delivery thereof to Buyer.

18.2 Seller agrees to pay or cause to be paid to the parties entitled thereto all royalties, overriding royalties, payments out of production, and other like charges applicable to all gas prior to its delivery to Buyer.

ARTICLE XIX—*NOTICES*

19.1 All notices to be given hereunder shall be in writing and shall be sent by prepaid mail or telegram addressed to the respective parties at the addresses stated below or to such other addresses as they shall respectively designate hereafter in writing from time to time:

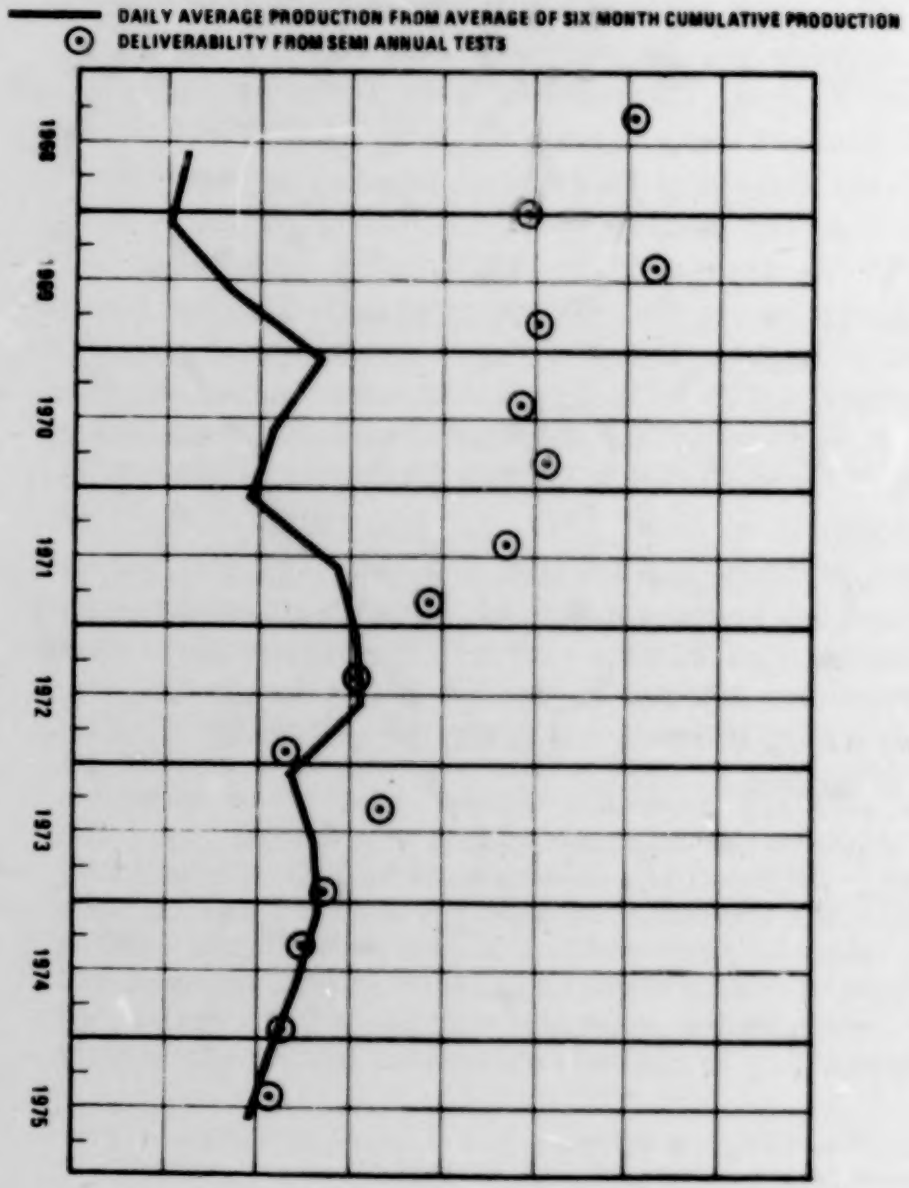
To Seller: Shell Oil Company
Post Office Box 60193
New Orleans, Louisiana 70160
Attention Natural Gas Marketing

To Buyer Florida Gas Transmission Company
2240 The 1100 Milam Building
Houston, Texas 77002
Attention Gas Contracts Department

19.2 From time to time, Buyer may notify Seller (or such representative Seller may designate from time to time, in writing, by telegram or orally

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APPENDIX B
PAGE 1 OF 2
SHELL OIL COMPANY
WEST WAHA FIELD
REEVES COUNTY, TEXAS



APPENDIX B
Page 2 of 2

The graph attached hereto shows the way that the deliverability provision actually works as a producing gas field declines. The example is an actual producing field in Reeves County, Texas, the West Waha Field. A copy of the Gas Sales Contract is attached as Appendix A, Part 3. The circles show the actual deliverability of the field, as determined by deliverability tests taken every six months by the pipeline purchaser, El Paso Natural Gas Company. The solid line is the amount of gas actually taken by El Paso. During the early stage of the field's depletion cycle, the deliverability of the wells greatly exceeded the ability of El Paso's facilities to take the gas. Beginning in about 1972, the deliverability of the field had declined, so that from that time on, the take was restricted by the capacity of the wells to deliver. Under Section _____ of the Contract, the deliverability requirement was adjusted accordingly. This is the usual and normal situation as the ability of a reservoir to deliver gas declines.

* * *

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Services Under Certificated Arrangements	))))	Docket No. RM76-8

JOINT PETITION FOR STAY[1]

I.

On October 14, 1975, the Commission issued Order No. 539 in this docket. Order No. 539 deals generally with producers' delivery obligations under certificates of public convenience and necessity authorizing sales of gas for resale in interstate commerce under standard producer contracts.

Order No. 539 promulgated Section 2.83 of the Commission's General Policy and Interpretations. The language of Section 2.83 has created uncertainty as to the rate of delivery obligation that will be imposed under certificates authorizing the sale of gas for resale in interstate commerce. Specifically, a question exists as to whether such certificates will impose on producers an obligation to deliver a specific volume of gas at a specific rate. If such a warranty obligation is contemplated, Petitioners view it as unreasonable and unlawful. Consequently, Petitioners are filing simultaneously herewith a petition seeking clarification and rehearing of Order No. 539 in an attempt to establish as expeditiously as possible the nature of the delivery obligation contemplated. In view of the critical nationwide shortage of gas, however,

[1] This petition is joined in and submitted on behalf of Tenneco Oil Company, Tenneco Exporation, Ltd., Pennzoil Company, Pennzoil Producing Company, Pennzoil Offshore Gas Operators, Inc., and Pennzoil Louisiana and Texas Offshore, Inc., hereinafter referred to as Petitioners.

it is imperative that Petitioners not be required to operate under such uncertain and possibly unlawful conditions.

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Issuance of the stay will allow the continuance of normal operations while at the same time avoiding the irreparable injury to Petitioners that would result from the imposition of what Petitioners deem to be an unlawful delivery obligation until such time as the true nature and validity of that obligation can be determined.

II.

Under the standard set forth in *Virginia Petroleum Jobbers* v. *FPC*, 259 F.2d 291 (D.C. Cir. 1958), a stay is appropriate in this case so long as there is a substantial probability that (1) Petitioners will prevail on appeal, (2) Petitioners will suffer irreparable harm absent a stay, (3) the stay will not cause injury to other parties, and (4) the public interest favors a stay. Although it is not essential that the Commission find that each of these elements is present in order to issue a stay,[2] each is present in this case and therefore a stay is appropriate.

A. *Petitioners Will Prevail On Review*

Section 2.83 provides, in essence, that the rate of dedivery is to be determined in accord with the terms of the contract between seller and purchaser.[3] The standard producer contract provides that the producer will sell and deliver to the purchaser the gas produced from the dedicated acreage at a rate the producer determines does not exceed the volume which can be produced consistent

[2] See *Amoco Production Company*, RI71-691, *et al.* (Order Granting Motion for Stay, December 30, 1974.

[3] Section 2.83(d) also provides that express conditions contained in the certificate will control over contrary contract provisions.

with prudent operations.[4] Consequently, under the standard producer contract, the producer undertakes a prudent operations delivery obligation rather than a warranty delivery obligation. Thus, if the affect of Order No. 539 is to expressly incorporate the contractual delivery obligation into the certificate, then a warranty obligation will not be imposed and Petitioners will prevail on their petition for clarification.

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If, however, the purpose of Order No. 539 is to incorporate the contractual delivery obligation, but a warranty obligation is in fact to be imposed as a result of the Commission's construction of standard producer contracts, then the Commission has seriously misconstrued such contracts. The implication of Order No. 539 is that a producer has an unqualified contractual obligation to deliver a specific volume of gas which will be someh w determined by reference to the purchaser's take or pay obligation but without reference to prudent operation considerations. There is nothing in the standard producer contract that either expressly or by implication supports that conclusion.

First, some standard contracts do not even provide for the reserve determination that Order No. 539 contemplates.[5] Consequently, whatever Order No. 539 provides, such contracts cannot possibly be construed so as to bring them within the ambit of that Order.

[4] While the terms of producer contracts vary widely, almost all provide for delivery based on prudent operation considerations. Since Order No. 539 deals with delivery rates, the term standard producer contract as used herein refers to the delivery provision of producer contracts.

[5] Some of these reserve determinations may involve confidential and proprietary data, yet Section 2.83 makes no provision for confidential treatment. Issues relating to the confidential nature of reserve estimates and related data are currently pending before the Fifth Circuit in *Pennzoil Co., et al.* v. *FPC*, Nos. 75-2961 *et al.*, United States Court of Appeals for the Fifth Circuit, docketed July 25, 1975.

The Commission's use of the reserve determination clause in Order No. 539 is based on an assumption that a standard producer delivery obligation provision exists. This assumption is absolutely correct. The reason that some contracts nonetheless do not fit within the reserve determination terms of Order No. 539, however, is that reserve determinations do not establish delivery obligations. Instead, they relate to take or pay provisions. The fundamental defect of Order No. 539 then, is that it focuses on the wrong contract provision.

The pertinent contract provision is the prudent operations provision. Under this provision, which is in every standard producer contract, account is taken of the practical restraints associated with undertaking to produce and deliver gas and the producer's delivery obligation is tempered by and made subject to those practical restraints. Simply put, the physical restraint is that it is impossible to predict the volume of gas that can be produced and the rate at which it can be produced. That determination is basically a matter of judgment, and varies constantly as a multitude of variables which enter into the judgment vary. Thus the standard contract provides the only reasonable basis upon which producers can obligate themselves to deliver the gas produced. Such contracts provide that, notwithstanding any other provision of the contract, the Producer is not bound

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to perform any act which the producer deems to be inconsistent with prudent operations. A contract of this nature does not impose a warranty obligation. *South Texas Natural Gas Gathering Company*, Docket No. CP67-349, 51 FPC 245 (Initial Decision 1973) aff'd. 51 FPC 231 (1974). The Commission has therefore misconstrued the standard producer contract and Order No. 539 must be amended to accurately reflect the correct interpretation.

Furthermore, nothing in the standard producer certificate application can or should be read as a proposal to undertake a delivery obligation in any way inconsistent

with the underlying contractual delivery obligation. Uncertainty in this regard has been created by a suggestion that the "Estimated sales volumes" contained in the contract summary portion of a certificate application and in the sample billing statement of a corresponding rate schedule may impose an obligation to deliver such estimated volumes.[6] Those estimates are made pursuant to Sections 157.24 and 154.93 of the Commission's Rules and Regulations, which relate "strictly to procedural matters." Order No. 174-B, Docket No. R-138 (Order issued December 17, 1954). The substance of the application is the contract, the contents of which most assuredly control over summaries and estimates made for procedural purposes only. Existing certificates certainly have no express warranty conditions, and the Commission has done nothing to indicate that existing authorizations contain such a condition. To the contrary, the Commission has held that, absent express warranty language in the contract or the certificate, no such obligation is present. *South Texas Natural Gas Gathering Company, supra.*

Order No. 539 certainly can not modify existing authorizations. And as to future authorizations, nothing in the standard producer application can be the basis for the imposition of a warranty obligation.

A producer therefore has no contractual obligation under a standard producer contract to deliver a specified volume of gas at a specific rate, nor does the standard certificate application propose such an obligation. Consequently, if a warranty obligation is to exist, it will be imposed by the Commission. The Commission, however, has no authority to impose such a condition.

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Section 1(b) of the Natural Gas Act provides that the Act "shall not apply to . . . the production . . . of natural

[6] This suggestion is contained in a letter from John N. Nassikas, former Chairman of this Commission, to Congressman John E. Moss. The letter is dated October 14, 1975, the same date Order No. 539 was promulgated. A copy of the letter is attached as Exhibit A.

gas." This exemption has been construed to encompass "the physical activities, processes and facilities of production . . . ." *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392, 402 (1965). Rate of delivery is, of course, a direct result of rate of production. And rate of production is most certainly a "physical activity of production". The Commission's attempt to require a rate of delivery from the acreage covered by the dedication other than that which may be proposed in the contract is therefore proscribed by Section 1(b) of the Act.

Indeed, not only has Congress expressly excluded production activities from the jurisdiction of the Commission, but furthermore that area has been fully occupied by other administrative bodies. As to the offshore Federal domain, Congress has granted the Department of the Interior (Interior) full authority over production activities. Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331-1343. Pursuant to this authority, Interior has issued regulations covering "drilling and production operations . . . and in general, all operations conducted on a lease by or on behalf of a lessee." 30 C.F.R. § 250.10. And Interior has issued a specific regulation dealing with rates of development and production based on a prudent operations rate of production standard. 30 C.F.R. § 250.33.

As to acreage within the control of the states, it has long been recognized that the states have full authority over production activities. *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944). And the states have exercised their authority with respect to matters that determine rate of production, such as production allowables and spacing of wells. E.g., TEX. REV. CIV. STAT. ANN. Art. 6049c (1962).

The imposition of a warranty delivery obligation is therefore both beyond the Commission's authority and an intrusion on the authority of both Interior and state regulatory bodies.

Even if the Commission did have the authority to impose a warranty delivery obligation, the imposition of such a condition would be unreasonable and contrary to the public interest. In essence, such a condition would require producers to guarantee the occurrence of an event over which they have no control. Producers do not and cannot know to a certainty the volume of recoverable reserves that underlay acreage they propose to dedicate. Producers do not know and

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can not know to a certainty the characteristics of the reservoirs in that acreage. Finally, producers can not predict what unexpected but possible events might occur during the producing life of the acreage. All of these unknown and unknowable factors will dictate the rate at which the gas can be produced.

A warranty obligation thus ignores a basic feature of the gas producing industry—risk. Petitioners are willing to take necessary risks, but they are not willing to guarantee the outcome of such ventures. The only thing that can be guaranteed is that the service they propose will be conducted in a prudent manner. To require more is to ignore reality and impose an unreasonable burden.

As a result of the unreasonable burden that a warranty delivery obligation would impose, the public interest would be adversely affected by such an obligation. Certainly the public is best served by actions conducted in a prudent manner and not by actions dictated by arbitrary assumptions and conditions. A warranty delivery obligation is based on arbitrary assumptions and can only lead to imprudent results because the assumptions will inevitably prove to be inaccurate. The actual maximum efficient rate of production will in many cases be less than the predicted delivery rate. A warranty would then require production in a manner which may damage the wells or the reservoir with an inevitable ultimate loss of production, a result clearly contrary to the public interest.

Moreover, the Commission's action in promulgating Order No. 539 is procedurally defective. The procedural prerequisite to a particular Commission action is dependent upon the true nature and effect of that action. Thus, the Commission must "realistically tailor the proceedings to fit the issues before it . . . ." *City of Chicago* v. *FPC*, 458 F.2d 731, 744 (D.C. Cir. 1971), cert. denied, 405 U.S. 1074 (1972). As discussed above, absent express language to the contrary, producer certificates do not and never have imposed a warranty delivery obligation. *South Texas Natural Gas Gathering Co., supra.* Consequently, if the effect of Order No. 539 is to incorporate a warranty delivery obligation into all certificates issued pursuant to standard producer applications based on standard producer contracts, then Order No. 539 is nothing less than a new rule of general applicability.

The simple expedient of characterizing the action as a "statement of policy" certainly does not convert what is in fact a new rule into a policy statement. And it is

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clear that, however characterized, Order No. 539 is not a statement of policy. As stated in *Pacific Gas and Electric Co.* v. *FPC*, 506 F.2d 33, 38 (D.C. Cir. 1974):

> "A general statement of policy is . . . [not] a precedent but is merely an announcement to the public of the policy which the agency *hopes to implement in future rulemakings or adjudications.*" (Emphasis added.)

As a result, and as also recognized in *Pacific Gas and Electric Co.*:

> "A general statement of policy . . . does not establish a 'binding norm'. *It is not finally determinative of the issues or rights to which it is addressed.* The agency cannot apply or rely upon a general statement of policy as law because a general statement of policy only announces what the agency seeks to establish as policy. A policy statement announces the agency's tentative intentions for the future. *Id.* (Footnote omitted) (Emphasis added).

Yet in Order No. 539, the Commission has stated that certificates issued after October 14, 1975 "shall include" the conditions described in Section 2.83(d), which most certainly is a final determination of the issues and rights addressed by Order No. 539.

While Order No. 539 therefore establishes a new rule, the Commission has failed even to accord "to interested parties a simple notice and right to comment", which are "the minimum protections upon which administrative action may be based" under Sections 4 and 5 of the Administrative Procedure Act (APA)[1] *Mobil Oil Corporation* v. *FPC*, 483 F.2d 1238 (D.C. Cir. 1973). This failure renders Order No. 539 procedurally defective. *Texaco, Inc.* v. *FPC*, 412 F.2d 740 (3d Cir. 1969).

Moreover, as stated in *Mobil Oil Corporation* v. *FPC*, *supra*, "an examination of the purposes and provisions of the substantive statute being administered may require that more than the comparatively feeble protections of Section 553 of the APA may be called for." Here, the substantive statute involved is Section 7(c) of the Natural Gas Act, under which Commission decisions must be supported by substantial evidence. Consequently, a more formal procedure than that contemplated by Section 553 of the APA is required here.

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Mobil Oil Corporation v. *FPC*, *supra*. The Commission's failure to meet even the "comparatively feeble" protection of section 553 is therefore clearly error.

In sum, if Order No. 539 contemplates a warranty delivery obligation, it must be amended to delete that obligation. The standard producer contract imposes no such obligation and the standard producer certificate obligation does not propose a warranty obligation. The Commission does not have the authority to impose such a condition, and has never attempted to do so in the past. Even if the authority existed, Order No. 539 certainly

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[1] 5 U.S.C. § 553.

can not so condition already existing certificates, and the imposition of such a condition in the future would be unreasonable and contrary to the public interest.

In view of the foregoing, it is clear that, upon review, it will be determined either that a warranty delivery obligation is not contemplated by Order No. 539 or that such an obligation can not and should not be imposed. There is a substantial probability that Petitioners will prevail on the merits and thus a stay is justified.

B. *Failure To Stay Will Result In Irreparable Harm to Petitioners*

In the absence of a stay, Petitioners will be forced to operate under uncertain conditions relating to the very heart of Petitioner's operations. The uncertainty has been identified and by a petition for clarification Petitioners have sought an expeditious resolution of the question. Under these circumstances, fundamental fairness and due process demand that the nature of the condition be clarified immediately.

Moreover, in the event the Commission determines that a warranty obligation is present, Petitioners will then be in a position of having to operate under what they deem to be an unlawful condition. The impact would be immediate and would adversely effect both Petitioners and the public interest since Petitioners would be forced to make decisions effecting the public interest on the basis of unreasonable and arbitrary conditions.

C. *A Stay Would Not Cause Harm To Other Parties*

A stay will not cause harm to other parties. To the contrary, the imposition of an unreasonable delivery obligation based on arbitrary assumptions can only lead to

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imprudent results in terms of the maximum benefit to be gained from production activities. This adverse impact will be felt not only by Petitioners, but also by Petitioners' purchasers and their customers. Thus the only harm associated with the petition for a stay is that which will result in the event the stay is denied.

D. *The Public Interest Favors A Stay*

The issue posed by Order No. 539 and Section 2.83 is both serious and complex and its resolution could have a substantial impact on the natural gas industry and on natural gas consumers. An issue as far reaching and complex as this should not be resolved without the most careful consideration and deliberation. Yet if a stay is not granted, the issue will be resolved, at least on a temporary basis, and its impact will be felt immediately. And this would occur without providing Petitioners the opportunity to present the sound reasons militating against the imposition of a warranty delivery obligation. The public interest demands that such precipitous action not be taken. A stay will allow time for reasoned consideration while at the same time avoiding the immediate adverse impact that a warranty delivery condition would create.

III.

For the foregoing reasons, Petitioners request that the Commission stay the effective date of Order No. 539 until such time as the issues raised in that Order have been fully considered and resolved. Petitioners request that the Commission act promptly on this petition.

Respectfully submitted,

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3000 One Shell Plaza
Houston, Texas 77002
Attorneys for Petitioners

THE STATE OF TEXAS)
)
COUNTY OF HARRIS)

Stephen M. Hackerman, being first duly sworn, deposes and says: That he is lawyer for Petitioners, that the statements contained in the foregoing Joint Petition for Stay are true and correct to the best of his knowledge and belief, that he is authorized to file the same, and now does so upon his oath.

/s/ Stephen M. Hackerman
STEPHEN M. HACKERMAN

Subscribed and sworn to before me by the said Stephen M. Hackerman this 12th day of November, 1975, to certify which witness my hand and seal of office.

/s/ Linda S. Lee
Notary Public in and for
Harris County, Texas

I hereby certify that I have this day served a copy of the Joint Petition for Stay upon each person designated on the official service list compiled in accordance with the requirements of § 1.17 of the Rules of Practice and Procedure.

Dated at Houston, Texas this 12th day of November, 1975.

/s/ Stephen M. Hackerman
STEPHEN M. HACKERMAN

FEDERAL POWER COMMISSION
Washington, D.C. 20426

Oct. 14, 1975

Honorable John E. Moss
Chairman
Oversight and Investigations Subcommittee
Committee on Interstate and Foreign Commerce
House of Representatives
Washington, D. C. 20515

Dear Chairman Moss:

Please be advised that contrary to the misconception, or misunderstanding of your staff members, I did not, in fact, indicate to them that this Commission by "oversight, neglect or sheer dereliction" had failed to see that a minimum deliverability volume of natural gas was included in all certificates for the interstate sale of gas. The fact is that every certificate issued by this Commission is expressly conditioned upon the applicant, producer-seller continuing the service authorized by the Commission until a proposed change in such service is authorized by the Commission.

As to deliverability itself, Section 157.23 of the Regulations, which you cite in your letter, provides for the filing of certificate applications by all producers, and further provides, *inter alia*, that those producers selling less than one million Mcf of gas annually may file a short form of application set out in Exhibit A to the regulation. Item (8) (c) of the short form calls for "Contract Volumes Mcf (daily or annually), indicating pressure base." However, the filing of the short form is optional and the producer-seller may file a longer form which is required of those producers selling over one million Mcf of gas annually. Very few producers have availed themselves of the option of filing the short form.

Section 157.24 is the section of the Regulations applicable to, and under which, almost all producers have filed for certificates to sell natural gas in interstate commerce. That section requires that an application be filed in the form specified in Section 250.5 of the Regulations. Section 250.5 "Form of Contract Summary . . ." has as an item under Part I thereof, item "(13) Estimated sales volumes (Mcf per month)." This information is required of all applicants other than those small producers who may have filed under Section 157.23. In addition thereto, Section 154.92(b) of the Regulations requires every producer who proposes to initiate a sale of natural gas to file with the Commission not less than 30 days, nor more than 90 days prior to the date of commencement of the sale, *inter alia*, "a statement showing estimated sales and billing for the first month of service, in sufficient detail to show method of billing and prices used." Of course, the estimated sales would be the volume to be delivered.

To my knowledge, these regulations have been enforced since I became Chairman of this Commission in 1969, and no negligence in the discharge of duties thereunder by the Commission has occurred.

You have requested that I inform you "within the next few days as to the number of contracts that have been reviewed to date for compliance with C.F.R. 157.23 and the number of certificates reviewed which do not contain a deliverability requirement." As previously indicated, it is only small producers who have the option of filing the short form set out in Exhibit A to Section 157.23, and as I stated, very few small producers have utilized the short form. I have requested our staff to review the number of contracts filed, and the number of certificate applications filed, if any, wherein the contract summary required by Section 157.23 or Section 250.5 has not contained the required deliverability information. I am advised that a preliminary review reveals that all of the certificate applications covered thereby have complied with Section 250.5.

I am further advised that all the applicants, whose applications were reviewed, have also complied with Section 154.92 of the Regulations by filing the billing statement from which the estimated monthly deliveries can be determined, and which can be used as a check against the contract summary.

As previously indicated, all certificates issued by this Commission to a natural gas producer authorizing the sale of gas is for a fixed quantity of gas to be computed in accordance with the terms of the particular sales contract which is the basis of the application. The volume of gas to be delivered initially under the certificate authority is almost always determined by a daily delivery ratio of the initial volume of gas estimated to be recoverable from the acreage dedicated under the contract. Of course, the Commission may, and has on occasion, condition the grant of the certificate to vary the terms of the delivery obligation or the acreage dedication contained in the contract.

We do not assert, nor is it feasible under the contract-based scheme of regulation provided for in the Natural Gas Act, that we have devised a warranty-type certificate authorization for all the jurisdictional producer sales. The rate of delivery of gas from any given reservoir will vary according to differing reservoir conditions, such as whether the gas is dissolved, solution or casinghead gas, *i.e.*, gas produced in a liquid, or whether it is gas-well gas or dry gas. Additionally, the reservoir type will vary, such as an aquifer or water-drive reservoir, gas pressure-drive, or whether the gas is pumped from the reservoir with oil or condensate. The area of production will also cause variances in the flow rate of the gas. Certain areas of production, particularly in off-shore South Louisiana are prone to produce large volumes of salt-water and sand if the rate of production is increased to the absolute flow capability of the producing formation. Consequently, engineering considerations must be given weight and the production of the particular reservoir

must be monitored from time to time to assure that all of the producible reserves are in fact recovered, and substantial quantities of gas not lost because of loss of deliverability due to choking out the reservoir from water, sand or a combination of both.

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Accordingly, it is typical of most producer contracts filed with the Commission to provide for tests to redetermine deliverability based on depletion curves, flow, pressures and other means of ascertaining the remaining recoverable reserves and the resultant deliverability redetermination.

I agree that the entire matter of delivery obligation under certificates issued by this Commission is of great importance, and, further I agree that some confusion seems to have occurred regarding the certificated contract obligation of jurisdictional producers. In view of that, I initiated some time ago, a review of the pipeline purchasers and producers practices in assuring that the certificated contract volumes were, in fact, being delivered to, and taken by the pipelines.

I have no doubt of this Commission's statutory and legal authority to compel delivery of the volumes which it certificates in *Sunray Mid-Continent Oil* v. *F.P.C.*, 364 U.S. 137, 156 (1960) in affirming the Commission in a case directly concerning the nature of the service certificated, the Supreme Court said that the Commission:

> * * * has long drawn a distinction between the underlying service to the public a natural gas company performs and the specific manifestation—the contractual relationship—which that service takes at a given moment.
>
> * * * * *
>
> This position of the Power Commission is evidence that the service in which the producer engages is distinct from the contract which regulates his rela-

tionship with the transmission company in performing the service.

* * * * *

Further, the Power Commission has from an early date taken the view that there is a continuing obligation to perform "service" imposed by the Act which outlasts the term of a seller's original contract of sale. As early as 1942 it held that an abandonment of service after the expiry of such a contract had to have Commission approval under § 7(b).

* * * * *

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Our consideration of this, as well as the rest of petitioner's arguments, leads us to reiterate as our holding the clear implication of what we recently said in *Catco*: An initial application of an independent producer, to make movements of natural gas in interstate commerce, leads to a certificate of public convenience and necessity under which the Commission controls the basis on which "gas" may be initially dedicated to interstate use. Moreover, once so dedicated there can be no withdrawal of that supply from continued interstate movement without Commission approval.

The *Sunray* case then is cited, among others as authority for the rule of law that:

> "Like the ancient covenant running with the land, the duty to continue to deliver and sell, flows with the gas from the moment of first delivery down to the exhaustion of the reserve, or until the Commission, on appropriate terms, permits cessation of service under Section 7(b)." *Hunt* v. *FPC*, 306 F.2d 334, 342 (1962).

As I pointed out to you in my letter of July 18, 1975, this Commission has recently restated this doctrine in its Opinion No. 724, *Blair-Vreeland*, Docket No. CI74-331, May 14, 1975; Opinion No. 733, *Mitchell Energy Corpo-*

ration, Docket No. CI75-296, June 11, 1975, and in its Opinion No. 737, *El Paso Natural Gas Company, et al.*, Docket Nos. CP75-209, *et al.*, July 11, 1975.[1]

With reference to the last paragraph on page two of your letter, you should be advised that a study similar to the one you request is in preparation for the House Subcommittee on Energy and Power, Committee on Interstate and Foreign Commerce as the result of hearings held before that Subcommittee on September 26, 1975. However, that study is not directed to Section 157.23 alone. It is directed to the three year period, 1972-1974, which is the latest three year period for which delivery volumes are now available. Specifically the study encompasses the following information with respect to sales by natural gas producers to Columbia Gas Transmission Corporation (include Columbia Gulf Transmission Corporation), Panhandle Eastern Pipe Line Company, Texas Eastern Transmission Corporation, and Transcontinental Gas Pipe Line Corporation:

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1. Each certificate issued to a producer for a sale to one of the four named pipelines since January 1, 1972;
2. The date of the certificate;
3. The amounts of gas to be delivered as shown in the application;
4. Amounts of gas to be delivered as shown in the certificate;
5. Amount of gas to be delivered as shown in each contract made under that certificate; and
6. Amounts of gas actually delivered each year since January 1, 1972, under each such contract.

This study will be completed within the next ten days and a copy of it will be transmitted to you coordinately

[1] Judicial review of Opinion Nos. 733 and 737 has been sought in separate appeals by the producer respondents in each proceeding in the U.S. Court of Appeals for the Fifth Circuit.

with its transmittal to the House Subcommittee on Energy and Power, Committee on Interstate and Foreign Commerce. To provide your Subcommittee with a like study for all certificates granted to all producers within the past three years will require an estimated six months for our staff to complete. I would appreciate your advising me whether you want us to make such a study for all producer certificates to all interstate natural gas pipe lines, or whether the study requested by the Subcommittee on Energy and Power will suffice.

Sincerely,

/s/ John N. Nassikas
JOHN N. NASSIKAS
Chairman

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Services Under Certificated Arrangements	))))	Docket No. RM76-8

JOINT PETITION FOR CLARIFICATION, REHEARING AND RECONSIDERATION [1]

Pursuant to Section 19(b) of the Natural Gas Act and Section 1.34 of the Commission's Rules and Regulations, Petitioners respectfully submit their Petition for Clarification, Rehearing and Reconsideration of the Commission's Order No. 539 issued in this docket on October 14, 1975.

I.

Order No. 539 deals generally with producers' delivery obligations under certificates of public convenience and necessity authorizing sales of gas for resale in interstate commerce under standard producer contracts. Order No. 539 and Section 2.83 of the Commission's General Policy and Interpretations promulgated thereunder appear to provide that the rate of delivery under such certificates is to be determined in accord with the terms of the underlying contract between seller and purchaser.[2]

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[1] This petition is joined in and submitted on behalf of Tenneco Oil Company, Tenneco Exploration, Ltd., Pennzoil Company, Pennzoil Producing Company, Pennzoil Offshore Gas Operators, Inc., and Pennzoil Louisiana and Texas Offshore, Inc., hereinafter referred to as Petitioners.

[2] Section 2.83(d) also provides that express conditions contained in the certificate will control over contrary contract provisions.

The standard producer contract [3] provides that the seller will sell and deliver to the purchaser the gas produced from the dedicated acreage at a rate which the producer determines does not exceed the volume which can be produced consistent with prudent operations. The factors which determine the volumes that can be produced consistent with prudent operations continuously vary and thus rate of production continuously varies. If Order No. 539 contemplates a certificate delivery obligation based on the contractual prudent operations standard and automatic variance of that rate as the amount of gas which can be produced under prudent operations varies, Petitioners seek only a clarification to that effect.

II.

The language of Section 2.83 and other recent developments create some uncertainty, however, as to the precise delivery obligation that will be imposed. Specifically, Section 2.83(d) requires submission to the Commission of the results of certain reserve determinations and redeterminations that are made under some standard producer contracts.[4] A possible reading of Section 2.83(d) is that those reserve determinations will be used to establish a minimum delivery obligation based upon take or pay provisions, and that once that specific volume is established, it cannot vary without authorization by vir-

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[3] While the terms of producer contracts vary widely, almost all provide for delivery based on prudent operation considerations. Since Order No. 539 deals with delivery rates, the term standard producer contract as used herein refers to the delivery provision of producer contracts.

[4] Some of these reserve determinations may involve confidential and proprietary data, yet Section 2.83 makes no provision for confidential treatment. Issues relating to the confidential nature of reserve estimates and related data are currently pending before the Fifth Circuit in *Pennzoil Co., et al.* v. *FPC*, Nos. 75-2961 *et al.*, United States Court of Appeals for the Fifth Circuit, docketed July 25, 1975.

ture of a certificate amendment. This warranty obligation would be totally inconsistent with delivery obligations under standard producer contracts.

Further uncertainty has been created by a letter from John N. Nassikas, former chairman of this Commission, to Congressman John E. Moss.[5] The lette.. is dated October

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14, 1975, the same date Order No. 539 was promulgated. In that letter, there is some indication that the "Estimated sales volumes" contained in the contract summary portion of a certificate application and in the sample billing statement of a corresponding rate schedule may impose an obligation to deliver such estimated volumes. This suggestion is totally inconsistent with the true nature of the delivery obligations proposed under most producer certificate applications.

The uncertainty that has been created, then, is whether certificate delivery obligations under certificates issued pursuant to standard producer contracts and certificate applications will amount to a warranty that certain specified volumes of gas will be delivered on a daily, monthly, or any other basis. If a warranty of a specific rate of delivery is to be imposed by certificates, Petitioners seek rehearing of the determination to impose that condition, and an order reversing that determination.

A. The Standard Producer Contract Does Not Contain A Contractual Obligation Amounting To A Warranty Of A Specific Volume Delivery Rate

Petitioners have no objection to an express certificate condition incorporating their contractual delivery obligations into certificates. Petitioners have always complied with such obligations and will continue to do so. But if in construing the standard contractual delivery obligation the Commission has concluded that it amounts to a warranty, the Commission has erred.

[5] A copy of this letter is attached as Exhibit A.

The implication of Order No. 539 is that a producer has an unqualified contractual obligation to deliver a specific volume of gas which will be somehow determined by reference to the purchaser's take or pay obligation but without reference to prudent operation considerations. There is nothing in the standard producer contract that either expressly or by implication supports that conclusion.

First, some standard contracts do not even provide for the reserve determination that Order No. 539 contemplates. Consequently, whatever Order No. 539 provides, such contracts cannot possibly be construed so as to bring them within the ambit of that Order.

The Commission's use of the reserve determination clause in Order No. 539 is based on an assumption that a standard producer delivery obligation provision exists. This assumption is absolutely correct. The reason that some

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contracts nonetheless do not fit within the reserve determination terms of Order No. 539, however, is that reserve determinations do not establish delivery obligations. Instead, they relate to take or pay provisions. The fundamental defect of Order No. 539 then, is that it focuses on the wrong contract provision.

The pertinent contract provision is the prudent operation provision. Under this provision, which is in every standard producer contract, account is taken of the practical restraints associated with undertaking to produce and deliver gas and the producer's delivery obligation is tempered by and made subject to those practical restraints. Simply put, the physical restraint is that it is impossible to predict the volume of gas that can be produced and the rate at which it can be produced. That determination is basically a matter of judgment, and varies constantly as a multitude of variables which enter into the judgment vary. Thus the standard contract provides the only reasonable basis upon which producers can obligate themselves to deliver the gas pro-

duced. Such contracts provide that, notwithstanding any other provision of the contract, the Producer is not bound to perform any act which the producer deems to be inconsistent with prudent operations. Thus, under the standard contract, the producer undertakes to deliver gas at a rate not inconsistent with prudent operations, the very antithesis of a warranty obligation.

Petitioners' position here is not a novel one. Indeed the precise issue as to a producer's delivery obligation under a standard producer contract has previously been presented, thoroughly investigated, and resolved by the Commission in a manner totally consistent with Petitioners' position. *South Texas Natural Gas Gathering Company*, Docket No. CP67-349, 51 FPC 245 (Initial Decision 1973), aff'd, 51 FPC 231 (1974). In that case, South Texas was delivering gas under a certificate issued pursuant to a contract under which the purchaser's minimum take or pay obligation was 265,000 Mcf per day. The reserves which had been dedicated under the contract were not sufficient to attain that delivery rate and South Texas therefore had been delivering less than 265,000 Mcf per day. The Commission Staff contended that the minimum take or pay quantity was also a minimum delivery obligation and that South Texas' failure to deliver that quantity was an unauthorized abandonment of service in violation of the Natural Gas Act.

In an opinion which was affirmed by the Commission, the Administrative Law Judge rejected Staff's assertion in no uncertain terms:

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> ". . . the pertinent provisions of the contracts were designed primarily to require the buyer, Transco, to take or pay for specific volumes of gas rather than to require South Texas to deliver such volumes to Transco. Staff infers that South Texas bound itself to deliver the daily contract minimum of 265,000 Mcf to Transco, but no such inference can legitimately be drawn from the contract of February 17, 1959, as amended by the contract of March 1, 1969." 51 FPC at 247.

And as to South Texas' obligations under the Natural Gas Act as a result of commencing service under its standard producer contract, the Judge concluded:

> "As to its alleged violation of the Act in failing to deliver a minimum of 265,000 Mcf of gas per day to Transco, it must be noted that South Texas did not warrant that it would make such deliveries upon acceptance of the certificate issued by the Commission on July 23, 1969. This necessarily follows in the absence of any express warranty language in the sales contracts between South Texas and Transco which would make South Texas a grantor of specific volumes to be sold irrespective of deliverability considerations over which Transco had no control. South Texas denies the existence of any express warranty and the Staff has not proven otherwise." 51 FPC at 252, 253.

In affirming the Judge's decision, the Commission determined that 265,000 Mcf per day was the purchaser's minimum take or pay quantity as contemplated by the contract and South Texas' certificate, and that South Texas had delivered less than that amount. Yet the Commission determined that South Texas had not failed to meet its certificate obligations:

> "While South Texas attained the 265,000 Mcf per day level of deliveries for a short time, it delivered decreasing amounts of gas as might be expected as its recoverable reserves were used and were found to be smaller than previously expected. Therefore its inability to deliver a minimum of 265,000 Mcf per day contemplated by the certificate does not necessarily show that it has abandoned its service to Transco. While there has been a definite diminution of its service, this is a result of circumstances relating to the McAllen Ranch Field and other fields containing dedicated reserves that are not within the control of South Texas. Therefore there is no reason on this record to conclude that South Texas has made an unauthorized partial abandonment of its service to Transco." 51 FPC at 237.

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Thus the Commission has previously correctly determined that neither a standard producer contract nor a certificate based on such a contract imposes a warranty delivery obligation. Order No. 539 must be amended to accurately reflect this determination.

B. Standard Producer Certificate Applications Do Not Propose A Delivery Obligation Inconsistent With The Standard Contractual Obligation

Nothing in the standard producer certificate application can or should be read as a proposal by producers to undertake a delivery obligation in any way inconsistent with the standard contractual delivery obligation. When producers apply for certificates, they undertake to perform the service described in the underlying contract. The substance of a producer's application is the contract. The estimate of monthly sales volume in the contract summary filed pursuant to Sections 157.24 and 250.5 of the Commission's Rules and Regulations and in the sample billing statement portion of the rate schedule filed pursuant to Section 154.93 certainly does not change the nature of the undertaking. The estimate is just what it states—an estimate. It cannot and should not be read as a binding obligation.

Furthermore, if there can be any doubt as to the nature of the undertaking, the contract itself most assuredly controls a summary of that very contract and a billing statement based on and attached to that contract. As specifically recognized by the Commission, Sections 157.24 and 154.93 relate "strictly to procedural matters." Order No. 174-B, Docket No. R-138 (Order issued December 17, 1954). The nature of the delivery obligation is certainly a matter of substance and is controlled by the contract. Existing certificates certainly have no express warranty conditions, and the Commission has done nothing to indicate that existing authorizations contain such a condition. To the contrary, the Commission has held that, absent express warranty language in the contract or the certificate, no such obligation is present. *South Texas Natural Gas Gathering Company, supra.*

Order No. 539 certainly can not modify existing authorizations. And as to future authorizations, nothing in the standard producer application can be the basis for the imposition of a warranty obligation.

C. The Commission Has No Authority To Impose A Warranty Obligation

A producer has no contractual obligation under a standard contract to deliver a specified volume of

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gas at a specified rate. Nor does the standard certificate application propose such an obligation. Consequently, if a warranty obligation is to exist, it will be imposed by the Commission. The Commission, however, has no authority to impose such a condition.

Section 1(b) of the Natural Gas Act provides that the Act "shall not apply to . . . the production . . . of natural gas." This exemption has been construed to encompass "the physical activities, processes and facilities of production . . . ." *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392, 402 (1965). Rate of delivery is, of course, a direct result of rate of production. And rate of production is most certainly a "physical activity of production". The Commission's attempt to require a rate of delivery from the acreage covered by the dedication other than that which may be proposed in the contract is therefore proscribed by Section 1(b) of the Act.

Indeed, not only has Congress expressly excluded production activities from the jurisdiction of the Commission, but furthermore that area has been fully occupied by other administrative bodies. As to the offshore Federal domain, Congress has granted the Department of the Interior (Interior) full authority over production

activities. Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331-1343. Pursuant to this authority, Interior has issued regulations covering "drilling and production operations . . . and in general, all operations conducted on a lease by or on behalf of a lessee." 30 C.F.R. § 250.10. And Interior has issued a specific regulation dealing with rates of development and production based on a prudent operations rate of production standard. 30 C.F.R. § 250.33.

As to acreage within the control of the states, it has long been recognized that the states have full authority over production activities. *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944). And the states have exercised their authority with respect to matters that determine rate of production, such as production allowables and spacing of wells. E.g., TEX.REV.CIV. STAT.ANN. Art. 6049c (1962).

The imposition of a warranty delivery obligation is therefore both beyond the Commission's authority and an intrusion on the authority of both Interior and state regulatory bodies.

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D. The Imposition Of A Warranty Delivery Obligation Is Contrary To The Public Interest

Even if the Commission did have the authority to impose a warranty delivery obligation, the imposition of such a condition would be unreasonable and contrary to the public interest. In essence, such a condition would require producers to guarantee the occurrence of an event over which they have no control. Producers do not and can not know to a certainty the volume of recoverable reserves that underly acreage they propose to dedicate. Producers do not know and can not know to a certainty the characteristics of the reservoirs in that acreage. Finally, producers can not predict what unexpected but possible events might occur during the producing life of the acreage. All of these unknown and unknowable

factors will dictate the rate at which the gas can be produced.

A warranty obligation thus ignores a basic feature of the gas producing industry—risk. Petitioners are willing to take necessary risks, but they are not willing to guarantee the outcome of such ventures. The only thing that can be guaranteed is that the service they propose will be conducted in a prudent manner. To require more is to ignore reality and impose an unreasonable burden.

As a result of the unreasonable burden that a warranty delivery obligation would impose, the public interest would be adversely affected by such an obligation. Certainly the public is best served by actions conducted in a prudent manner and not by actions dictated by arbitrary assumptions and conditions. A warranty delivery obligation is based on arbitrary assumptions and can only lead to imprudent results because the assumptions will inevitably prove to be inaccurate. The actual maximum efficient rate of production will in many cases be less than the predicted delivery rate. A warranty would then require production in a manner which may damage the wells or the reservoir with an inevitable ultimate loss of production, a result clearly contrary to the public interest.

E. The Commission's Action Is Procedurally Defective

The procedural prerequisite to a particular Commission action is dependent upon the true nature and effect of that action. Thus, the Commission must "realistically tailor the proceedings to fit the issues before it . . . ." *City of Chicago* v. *FPC*, 458 F.2d 731, 744 (D.C.Cir. 1971),

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cert. denied, 405 U.S. 1074 (1972). As discussed above, absent express language to the contrary, producer certificates do not and never have imposed a warranty de-

livery obligation. *South Texas Natural Gas Gathering Co., supra.* Consequently, if the effect of Order No. 539 is to incorporate a warranty delivery obligation into all certificates issued pursuant to standard producer applications based on standard producer contracts, then Order No. 539 is nothing less than a new rule of general applicability.

The simple expedient of characterizing the action as a "statement of policy" certainly does not convert what is in fact a new rule into a policy statement. And it is clear that, however characterized, Order No. 539 is not a statement of policy. As stated in *Pacific Gas and Electric Co.* v. *FPC*, 506 F.2d 33, 38 (D.C. Cir. 1974):

> "A general statement of policy is . . . [not] a precedent but is merely an announcement to the public of the policy which the agency *hopes to implement in future rulemakings or adjudications.*" Emphasis added.

As a result, and as also recognized in *Pacific Gas and Electric Co.*:

> "A general statement of policy . . . does not establish a 'binding norm'. *It is not finally determinative of the issues or rights to which it is addressed.* The agency cannot apply or rely upon a general statement of policy as law because a general statement of policy only announces what the agency seeks to establish as policy. A policy statement announces the agency's tentative intentions for the future." *Id.* (Footnote omitted) (Emphasis added).

Yet in Order No. 539, the Commission has stated that certificates issued after October 14, 1975 "shall include" the conditions described in Section 2.83(d), which most certainly is a final determination of the issues and rights addressed by Order No. 539.

While Order No. 539 therefore establishes a new rule, the Commission has failed even to accord "to interested parties a simple notice and right to comment", which are "the minimum protections upon which administra-

tive action may be based" under Sections 4 and 5 of the Administrative Procedure Act (APA)[6] *Mobil Oil Corporation* v. *FPC*, 483 F.2d

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1238 (D.C. Cir. 1973). This failure renders Order No. 539 procedurally defective. *Texaco, Inc.* v. *FPC*, 412 F.2d 740 (3d Cir. 1969).

Moreover, as stated in *Mobil Oil Corporation* v. *FPC*, *supra*, "an examination of the purposes and provisions of the substantive statute being administered may require that more than the comparatively feeble protections of Section 553 of the APA may be called for." Here, the substantive statute involved is Section 7(c) of the Natural Gas Act, under which Commission decisions must be supported by substantial evidence. Consequently, a more formal procedure than that contemplated by Section 553 of the APA is required here. *Mobil Oil Corporation* v. *FPC*, *supra*. The Commission's failure to meet even the "comparatively feeble" protection of Section 553 is therefore clearly error.

III.

In sum, if Order No. 539 contemplates a warranty deliver obligation, it must be amended to delete that obligation. The standard producer contract imposes no such obligation and the standard producer certificate application does not propose a warranty obligation. The Commission does not have the authority to impose such a condition, and has never attempted to do so in the past. Even if the authority existed, Order No. 539 certainly cannot so condition already existing certificates, and the imposition of such a condition in the future would be unreasonable and contrary to the public interest.

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[6] 5 U.S.C. § 553.

IV.

for the foregoing reasons, Petitioners request that the Commission clarify Order No. 539 so as to clearly establish that the delivery obligation contemplated thereby is not inconsistent with an obligation to deliver gas at a rate which the producer determines does not exceed that which can be attained in accordance with prudent operations. If an obligation inconsistent with the prudent operations obligation has been

imposed, Petitioners request that the Order be modified so as to eliminate the inconsistency.

Respectfully submitted,

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STATE OF TEXAS)
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Stephen M. Hackerman, being first duly sworn, deposes and says: That he is lawyer for Petitioners, that the statements contained in the foregoing Joint Petition for Clarification, Rehearing and Reconsideration are true and correct to the best of his knowledge and belief, that he is authorized to file the same, and now does so upon his oath.

/s/ Stephen M. Hackerman
STEPHEN M. HACKERMAN

Subscribed and sworn to before me by the said Stephen M. Hackerman this 12th day of November, 1975, to certify which witness my hand and seal of office.

/s/ Linda S. Lee
Notary Public in and for
Harris County, Texas

I hereby certify that I have this day served a copy of the Joint Petition for Clarification, Rehearing and Reconsideration upon each person designated on the official service list compiled in accordance with the requirements of § 1.17 of the Rules of Practice and Procedure.

Dated at Houston, Texas this 12th day of November, 1975.

/s/ Stephen M. Hackerman
STEPHEN M. HACKERMAN

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Services Under Certificated Arrangements	))))	Docket No. RM76-8

MOTION FOR ORAL ARGUMENT

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December 19, 1975

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Services Under Certificated Arrangements	))))	Docket No. RM76-8

MOTION FOR ORAL ARGUMENT

The undersigned producers (Shell Oil Company, *et al.*, hereinafter designated "Producers") pursuant to Sections 1.12 and 1.32(d) of the Commission's Rules of Practice and Procedure, respectfully move the Commission to order oral argument in the captioned proceeding. In support of this Motion, Producers allege and state as follows:

I. Introduction

The Commission was apparently under the impression when it issued Order No. 539 that it was not making any basic changes in industry practices or the Commission's jurisdiction or procedures under the Natural Gas Act (see p. 8, para. (1); p. 12. para. (f)). In the Application for Rehearing and Motion for Reconsideration filed by Producers, we sought to clarify what we believed to be a misunderstanding on the part of the Commission as to the obligations assumed by producers under their sales contracts to continue to deliver specific quantities of gas. While the Commission has not acted on our Application for Rehearing [1] the Commission has, in orders in other proceedings[2], evidenced an

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intent to make a drastic and basic departure from its previous administration of the Natural Gas Act, and is attempting to enter into areas which we believe to be beyond its legal jurisdiction. Even if we are incorrect on the law, and, contrary to our belief, the Commission has jurisdiction to condition certificates to require stated delivery obligations of producers, we believe that any attempt to do so represents a serious policy error by the Commission, and a direct conflict with the authorities which are now regulating such operations, the State Conservation Agencies and the U.S. Geological Survey.

It is further our belief that the Commission has been led into this error by three memoranda written by its Deputy General Counsel, dated June 18, 1975, July 18, 1975 and September 26, 1975, discussed before the Subcommittee on Energy and Power, Committee on Interstate and Foreign Commerce, United States House of Representatives, on October 24, 1975, Tr. 20121. We believe the Commission has further been unduly influenced by reports issued by the Subcommittee on Oversight and Investigations of the Committee on Interstate and Foreign Commerce of the House of Representatives. These reports are erroneous, and are based on a complete mis-

1. On November 28, 1975, the Commission granted rehearing for purposes of further consideration.

2. See, *e.g.*, *Natural Gas Pipeline Company of America, et al.*, Docket Nos. CP76-14, *et al.*, Ordering Paragraph (HH) setting out a "certificated minimum daily delivery obligations of the seller."

understanding of industry practices, the basic laws of reservoir engineering, and upon an inadequate record.

We are aware that the Commission now has three new members, who may not yet have had an opportunity to become familiar with industry practices and even the Commission's own procedures. Before undertaking a major policy step of the nature contemplated, and attempting to require delivery requirements on every gas field in the United States, we believe it is the duty of the Commission to fully inform itself and hear views from all parties. Order No. 539 manifestly did not make such a review, as no notice was issued and no comments received from any parties. Uniformly and without exception, all parties filing Applications for Rehearing from Order No. 539 have urged the Commission to reconsider its proposed policy and urged further that to implement this policy would be a violation of the Commission's jurisdiction under the Natural Gas Act. In Section III, *infra*, we will set out in detail the reasons

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and authorities why we believe the Commission does not have jurisdiction to require the delivery obligations of producers, contrary to the opinions expressed by the Deputy General Counsel in the memoranda above referred to. We urge the Commission to reconsider the policy questions raised herein, and to hear oral argument from all members of the industry and other interested parties, before reaching a decision on such important issues as these involved in this proceeding, some of which are outlined as follows:

II. An Attempt By The Federal Power Commission To Control Production Operations And Require More Rapid Depletion of Gas Reservoirs Is Wrong As A Matter Of Policy.

A. The Process Of Producing A Gas Reservoir Is A Complex Science, Which Differs With Each Reservoir.

The first fact which must be clearly understood by the Commission in considering the maintenance of deliveries from a gas reservoir, is the complexity of the subject with which it deals. At the risk of oversimplification, we will restate some of the basic facts.

Gas is entrapped in minute, often microscopic spaces in porous rock many thousands of feet beneath the surface. Also entrapped in these porous spaces may be quantities of liquid hydrocarbons and water. The kinetic and dynamic forces which interact and move the gas through these porous spaces to the well bore are extremely complicated, frequently unpredictable, and different with every reservoir in the United States. Like fingerprints, no two gas reservoirs are exactly alike. The thickness and areal extent of the sand, the pressure of the gas, the amount of liquid hydrocarbons or water present, the porosity and permeability of the sand, the reservoir drive mechanism, all are variables which operate to change the production characteristics of a reservoir. These same characteristics are the determinants of the ultimate recoverable

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gas reserves in each reservoir. As additional wells are

drilled, more is learned about the reservoir as different wells sample the reservoir at different points and determine the composition and thickness of the sand at those particular points. It must be remembered that gas wells are drilled on relatively wide spacing.[3]/ Thus, the operator is seeking to learn the production characteristics of the reservoir as well as the volume of gas in that reservoir by examining a core or cutting from a hole some six to nine inches in diameter, which wells may be located up to one mile apart. At the time of certification the gas fields are often newly discovered, only partially developed, and have no production history. It is apparent that a vast amount of technical judgment enters into these reserves estimates and production forecasts and both would be subject to substantial revisions as more information is obtained.

As the gas field produces, more is learned about the pressure and the production characteristics of the reservoir, including the rate at which the pressure will decline. One fact, however, must be firmly kept in mind, and that is that the quantity of gas in the reservoir is finite, and cannot be increased by the producer. All the producer can do is attempt to maximize the amount of the gas in the reservoir which is recovered at the surface. For each reservoir, this is a complicated process, and one involving a great deal of study on a continuous basis by qualified geologists and reservoir engineers.[4]/ Frequently such experts differ in their opinions as to the best manner

3. A common well spacing pattern required by State Conservation Agencies is 640 acres in the onshore mid-continent area.

4. See letter dated October 14, 1975 from former Chairman John N. Nassikas to Congressman John Moss discussing the complexities of the production process.

of developing and producing a particular reservoir. Additional capital expenditures do not always result in additional production. For example, testimony before the

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Subcommittee on Oversight and Investigations relating to the Bastian Bay Field in Southern Louisiana revealed the fact that additional wells drilled in the field would have to penetrate high-pressure water sands, and might result in the introduction of water at high pressure into the gas reservoirs which were still producing, thus reducing rather than increasing the production from the reservoir (see Subcommittee Report, November 1975, p. 35).

Gas reservoirs produce because there is one of two forces (or possibly both) in the reservoir which operate to move the gas through the porous spaces in the rock to the well bore. One of these is the pressure of the gas itself, which operates to move the gas out of the rock and into the area of lowered pressure created by the well bore. The other is the pressure of water within the formation, either below or adjacent to the gas accumulation, which operates as the driving force behind the gas. It is characteristic of a reservoir which produces by gas pressure that as the gas is produced, the pressure of the gas in the reservoir decreases. This is known as a "pressure depletion" type reservoir. In the case of the second type, or "water-drive" reservoir, the pressure may not decline, but the wells on the edge of the field will cease to produce as the water rises in the formation so that the edge wells will begin to produce water instead of gas. When this occurs these wells are plugged and abandoned. A great many reservoirs produce under some combination of these two mechanisms.

The point of this discussion is, that gas reservoirs decline in their ability to deliver gas to the pipeline over the life of the reservoir. This decline is occasioned entirely by natural forces, and is not the result of some desire on the part of the producer to withhold gas from the market to influence the price, as has been alleged by industry critics.

B. The Deliverability Requirement On The Producer.

As we set out in detail in our Application for Rehearing in this proceeding, producer contracts normally

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have not provided for any obligation on the part of the producer to deliver any specific quantities of gas from the reservoir. The contracts so provided because both parties recognized that the ability of the reservoir to produce would decline, at rates which neither party could accurately predict, at any time in the future.[5]/ Therefore, the producer was not, and could not be, held to any particular volume requirement for delivery. In those few unique contracts (called "warranty contracts") where the producer did undertake to deliver specific quantities, the understanding was based, not on deliveries from individual fields, but on the producer's anticipated ability to deliver the particular quantities from a number of fields or a particular area, or his right to substitute additional fields if the initial source did not deliver as the parties believed and hoped that it would.

5. Contract obligations were fully discussed in various producer Applications for Rehearing filed in this case.

To say that under the normal gas sales contract which provides for delivery of gas from a field, that a producer must justify any diminution of the deliverability of that field, is to provide for a continuous proceeding for every gas field in the United States. As a general rule, gas fields in the United States will decline in its ability to deliver gas, from the time the first delivery is made into the pipeline, until the last well is plugged. Therefore, in imposing a minimum daily delivery obligation in a certificate, the Commission would be undertaking to oversee and review whether, in each instance, the producer is doing everything in his power to maximize the production of the reservoir.

Because of the uncertainty and complexity of the subject, there are frequently grounds for disagreement as to whether additional operations would be beneficial or detrimental to the objective of maximizing production. In addition to differences of opinion as to what procedures will produce the maximum amount of reserves from the field, there is also the question of whether operations should be conducted in order to increase the speed at which the existing reserves are produced. In the course of developing a field, the producer develops a plan to optimize production from each reservoir. This is apparently the area in which the Commission Staff is in disagreement with some of the

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decisions made by producers, and this is the subject of the Commission's investigation in Docket No. RI75-112. It is apparent, however, that if the Commission intends to review the question of whether the producer is doing

everything possible to deliver gas reserves from every field in the United States as rapidly as possible, that it must at least quadruple its Staff, and spend thousands of man-hours not only of Commission time but of the time of industry experts, whose efforts would be better devoted to their primary job, which is to most efficiently produce these reservoirs, and to attempt to find additional reservoirs from which new gas can be produced. The Commission should seriously question whether its resources, and those of industry, could not more profitably be employed elsewhere.

C. Are There Situations In Which The Public Interest Would Be *Adversely* Affected By Accelerated Depletion?

The whole thrust of the position of those members of the Commission Staff and the House Subcommittee who advocate measures such as proposed by Order No. 539 is not that substantial additional reserves can be produced through additional expenditures, but merely that the depletion of existing reserves can be accelerated through substantial additional capital investment by the producer. Inherent in this issue are the following questions:

(1) Is the consumer benefited by obtaining the same quantity of gas sooner than otherwise might be the case, where in order to do so a capital investment of millions of dollars is required, which might otherwise be employed in finding new supplies of natural gas?

(2) Will the producer, particularly the smaller producer, be placed in severe financial straits

by Commission requirements to make additional capital expenditures which were not contemplated or budgeted by such party? This is, of course, an addition to the question

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whether the Commission has any legal power to require the producer to make additional capital expenditures, see Section III.B, *infra*.

(3) Will the risk of being required by the Commission to make substantial additional capital expenditures which the producer does not believe are justified, deter additional exploration operations, and force many small producers out of the business of exploring for natural gas?

(4) In addition to the risk of being required to make such capital expenditures, would the administrative burden of continually justifying the propriety of his production methods, force many producers, especially small producers, to sell their interests and retire from the natural gas business? Would this factor will operate to increase industry concentration and reduce competition, which is contrary to the general objectives of the Natural Gas Act and the public interest?

(5) Will increasing the speed at which the reservoir is depleted reduce the total amount of gas recovered from the reservoir, thus causing "waste" in violation of State Conservation Laws?

These complex questions should be thoroughly con-

sidered by the Commission, and can be explored more fully in oral argument.

D. The Sole Reason For This Expansion Of Commission Jurisdiction And The Imposition Of The Burden On The Industry Is The Unfounded Charge That Producers Are Withholding Gas Supplies.

Some members of the House Subcommittees and some members of the Commission Staff have apparently persuaded themselves, through constant repetition of the charges, that producers are withholding gas supplies from the American public. This is despite the fact that although

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these parties have been diligently seeking to prove these charges, they have completely failed to do so, although these efforts have encompassed a period of some five (5) years. The National Gas Survey conducted by this Commission, determined that for the period under study, the year 1970, the gas reserves as estimated by the Federal Power Commission Staff were substantially the same as those estimated by industry. The same result was obtained by the Federal Energy Administration Gas Survey conducted last year. Repeated audits by the Commission Staff in the *Southern Louisiana* case, and on the evidence submitted by the producers on uncommitted gas reservoirs in that case also proved that the industry estimates were reasonably accurate.

The most recent investigation of this problem is in the Investigation of Revised Curtailment Level on the System of Transcontinental Gas Pipe Line Corporation, Docket

No. RP75-51. The Staff Report, ordered placed in the Public Reference Room by Commission Order issued December 5, 1975, found as follows:

> ". . . based on the areas investigated the technical staff has not found any evidence of shut-in reserves being 'withheld from the market' or that there are wells capable of delivering in excess of current levels which can be legally (n. omitted) or in some cases, economically produced."
>
> . . . .
>
> It is the conclusion of the technical staff, based on the investigation just completed that further inquiry along the aforementioned approach will not turn up any effort or conspiracy on the part of the producer-sellers to withhold or conceal volumes of presently deliverable natural gas from the market. Any conspiracy at the level at which the technical staff investigated would necessarily

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> involve thousands of people and an attempt to cover up such an action would surely fail. The current investigation was sufficient to uncover anything of significance, although it may not have turned up every instance."

Even stronger proof that the industry is not holding back on gas deliveries is provided by the trend of statistics showing comparison between gas production and new supply additions over the last fifteen (15) years.

In 1950 only one twenty-fourth (1/24th) of the proven supply was produced annually. By 1974 one-tenth (1/10th) of the proven supply was being produced annually. The historical position of the producers has always been to produce the reservoirs as rapidly as feasible.[6]/

Of equal importance, is the fact that the producers do not conduct their production operations in a gas field without supervision, even though the Federal Power Commission is precluded by Section 1(b) of the Natural Gas Act from conducting such supervision (see Section III, *infra*). State Conservation Agencies in every major producing state maintain close supervision over production operations by oil and gas producers. It is a violation of law in practically all the oil and gas producing states to permit oil or gas to be wasted. In order to ascertain that no physical waste is occurring, the State Conservation Agencies maintain close supervision over these operations. As to casinghead gas, which is produced with oil, its rate of production is determined by the production rate permitted by the State Conservation Agencies for the oil. The number of gas wells which can be drilled in a field is controlled by the spacing orders of the State Conservation Agencies. Frequently, entire fields are unitized under the supervision of the State Conservation Agencies, in order to take full advantage

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of the producing characteristics of the reservoir to optimize recovery of the reserves. On Federal leases, the

6. See letter from Transcontinental Gas Pipe Line Corporation to Congressman John Moss dated November 15, 1975, pages 2-3.

same functions are performed by the U.S. Geological Survey. All of these actions are potentially in conflict with the type of regulation which the Commission now seeks to impose.

In addition to the State Conservation authorities, the producer's operations are continually monitored by the lessor, and are subject to the contractual obligations in the oil and gas lease, either express or implied, to operate the lease as an ordinary prudent operator. This is discussed in detail in Section III.D, *infra*.

E. Is Acceleration Of Production From An Existing Gas Reservoir In The Public Interest?

Underlying the entire issue is the question of whether it is really in the public interest to accelerate the depletion of existing gas reservoirs. As reservoirs near the later stages of their depletion cycle, the time for producing the remaining small percentage of the total reserves increases, as does the capital required to be expended to speed up this depletion. In every reservoir the time arrives when it is not economical for the producer, the pipeline, and the consumer to make substantial additional capital expenditures to recover small quantities of gas. Prior to that time, the question must be asked whether it is in the public interest to make additional capital expenditures to recover the same quantities of gas a few years sooner. If the real objective of the Commission is to maintain deliveries of gas supplies to its top priority customers over the long period of time, it would seem to be contrary to that policy to require gas reservoirs to be depleted hastily and plugged and abandoned, rather than gradually allowing their deliverability to decline, thus permitting a phasing out of

lower priority customers and the maintenance of delivery to residential and domestic customers for the longest possible period.[7]/ At least this is an issue which the Commission should

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carefully consider before concluding that it is in the public interest in all instances to produce gas reservoirs as rapidly as possible today.

III. The Attempt By The Commission To Control The Rate Of Depletion Of A Gas Reservoir Exceeds Its Jurisdiction Under The Natural Gas Act.

A. Production Operations Are Excluded From The Commission's Jurisdiction Under Section 1(b) Of The Natural Gas Act.

Even assuming, *arguendo*, that some case can be made for precipitously depleting the Nation's gas reserves, the Commission has no power under the Natural Gas Act to engage in this course of action.

Section 1(b) of the Natural Gas Act provides that "the provisions of this Act . . . shall not apply . . . to the production or gathering of natural gas." The scope of this exclusion from the Commission's jurisdiction has been the subject of interpretation by a number of court decisions. The first major decision was *Interstate Natural*

7. Only two years ago, the Commission issued an Order requesting all natural gas pipeline companies to "husband" existing gas supplies for high priority usage, see Order No. 498, Docket No. RM74-8, 50 F.P.C. 1954 at 1957.

Gas Co. v. F.P.C., 331 U.S. 682 (1947). The Court in that case carefully discussed the intention of Congress not to impose Federal Regulation over the "field operations" or production operations which were then being regulated by the State Conservation Agencies. The Court then carefully distinguished between the production and gathering operations themselves and the sales which were made after these operations were completed, see 331 U.S. 691-93.

In *F.P.C. v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949), the scope of the production and gathering exclusion was more fully explored by the Supreme Court. This case involved a transfer of oil and gas leases from Panhandle Eastern Pipe Line Company to an affiliate. The Commission urged that under Section 7(b) of the Natural Gas Act, which provides that no natural gas company could abandon jurisdictional facilities without Commission

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approval, that it had jurisdiction to prevent Panhandle from divesting itself of these leases. The Supreme Court disagreed, with the following language:

> "The Federal Power Commission leans heavily upon § 7(b) which provides that no natural-gas company may abandon any of its facilities subject to the jurisdiction of the Commission without the prior approval of the Commission. (n. omitted) The argument here is that since natural gas is the 'life blood' of the pipe-line system, a company by disposing of its gas reserves, unhampered by Commis-

sion control, may render itself unable to continue service; consequently abandonment of facilities and service without the consent of the Commission will result. The argument begs the question. The section, like those above, covers only 'facilities subject to the jurisdiction of the Commission.'

To accept these arguments springing from power to allow interstate service, fix rates, and control abandonment would establish wide control by the Federal Power Commission over the production and gathering of gas. It would invite expansion of power into other phases of the forbidden area. (n. omitted) It would be an assumption of powers specifically denied the Commission by the words of the Act as explained in the report and on the floor of both House of Congress. (n. omitted) The legislative history of this Act is replete with evidence of the care taken by Congress to keep the power over the production and gathering of gas within the states. (n. omitted) This probably occurred because the state legislatures, in the interests of conservation, had delegated broad and elaborate power to their regulatory bodies over all aspects of producing gas. (n. omitted)

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The Natural Gas Act was designed to supplement state power and to produce a harmonious and comprehensive regulation of the industry. (n. omitted) Neither state nor federal regulatory body was to encroach upon the jurisdiction of the other. (n.

omitted) Congress enacted this Act after full consideration of the problems of production and distribution. It considered the state interests as well as the national interest. It had both producers and consumers in mind. Legislative adjustments were made to reconcile the conflicting views." (337 U.S. at 509-13)

In *Phillips Petroleum Co. v. Wisconsin,* 347 U.S. 672 (1954), the case in which the Supreme Court found for the first time that the Commission should regulate sales for resale by producers of natural gas, the Court reiterated that the Commission had no jurisdiction over the physical activity or the facilities or properties used in the production of natural gas. The Court said:

"In Federal Power Com. v. Panhandle Eastern Pipe Line Co. 337 US 498, 505, 93 L ed 1499, 1505, 69 S Ct 1251, we observed that the 'natural and clear meaning' of the phrase 'production or gathering of natural gas' is that it encompasses 'the producing properties and gathering facilities of a natural-gas company.' Similarly, in Colorado Interstate Gas Co. v. Federal Power Com. 324 US 581, 598, 89 L ed 1206, 1220, 65 S Ct 829, we stated that '[t]ransportation and sale do not include production or gathering,' and indicated that the 'production or gathering' exemption applies to the physical activities, facilities, and properties used in the production and gathering of natural gas. Id., 324 US at 602, 603. See also Federal Power Com. v. Hope Natural Gas Co. 320 US 591, 612-615,

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88 L.Ed. 333, 350-352, 64 S.Ct. 281; Peoples Natural Gas Co. v. Federal Power Com. 75 App. D.C. 235, 127 F.2d 153; cf. United States v. Public Utilities Com. 345 U.S. 295, 307-311, 97 L.Ed. 1020, 1033-1035, 73 S.Ct. 706. (n. omitted) (347 U.S. at 678)

The efforts of the Commission to determine whether a producer has met a so-called minimum delivery obligation must lead inevitably to the question of whether the producer is properly engaging in the physical activity of producing gas from the reservoir. This is precisely the area regulated by the state authorities, and precisely the area which the Supreme Court in *Phillips I, Panhandle Eastern,* and the other cases cited above has stated that the Commission has no jurisdiction because of the exclusion under Section 1(b) of the Natural Gas Act.

It would be an error to find a producer to be in violation of any delivery obligation if the reservoir will not economically produce more than it is actually producing. As the physical ability of the reservoir to produce declines, this quantity will also decline. Therefore, in order to determine whether the delivery decline is permissible, the Commission would have to determine whether the producer is performing as an ordinary prudent operator. This inevitably involves inquiry into, and regulation of, the production operation, which is outside the Commission's jurisdiction, see *Saturn Oil & Gas Co. v. F.P.C.*, 250 F.2d 61 (10th Cir. 1957), cert. denied, 78 S.Ct. 542 (1958); *Deep South Oil Co. of Texas v. F.P.C.*, 247 F.

2d 882 (5th Cir. 1957); and *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392, 402 (1965).

Nor is the case of *Sunray Mid-Continent Oil Co. v. F.P.C.*, 364 U.S. 137 (1960), relied on heavily by the memoranda contending that the Commission has jurisdiction in this area, contrary to the above-cited cases. The *Sunray* case merely holds that a producer may not discontinue production from existing wells in a field after his contract with the pipeline purchaser has expired, unless approval to abandon is obtained under Section 7(b) of the Natural Gas Act. But there the Court was dealing with an attempted termination by the producer at a time when the field was

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admittedly capable of continuing production with existing producing facilities. Even though the producer may be required to continue to deliver gas under an existing interstate sale until the wells from which the gas is being delivered are depleted, the depletion of those wells operates as a practical limitation, and no authority of the Commission is required to plug and abandon such wells, see *Harper Oil Co. v. F.P.C.*, 284 F.2d 137 (10th Cir. 1960); *J.M. Huber Corporation v. F.P.C.*, 236 F.2d 550, 554 (10th Cir. 1956).

In fact, in the *Sunray* case, the Supreme Court specifically refused to decide the question of the application of Section 1(b) of the Act. The Court stated:

> "It is contended that the Commission's order, by requiring the petitioner to supply gas beyond the term of its contract, may, by requiring petitioner to

produce more gas than it has contemplated, offend the provision of § 1(b) of the Act that the Act does not apply 'to the production or gathering of natural gas.' The point was not raised before the Commission, and accordingly is not for our consideration here (n. omitted); and we might say in any event that the point is not for evaluation in this certification proceeding, but rather on the specific facts presented in the context of an abandonment application by petitioner under § 7(b), after the expiration of its contract, when and if it desires to make one. We intimate no view as to its merit." (n. omitted) (364 U.S. at 156-57)

B. Should The Commission Attempt To Issue An Order Requiring Expansion Of Production Facilities To Maintain Deliverability, It Would Be In Violation Of The Limitation On Its Jurisdiction Imposed By Section 7(a) Of The Natural Gas Act.

Section 7(a) of the Natural Gas Act contains express grant of jurisdiction to the Commission to direct

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a natural gas company to extend or improve its transportation facilities, but subject to the proviso that "the Commission shall have no authority to compel the enlargement of transportation facilities". If the Commission does not have any authority under the Act to require "enlargement" of transportation facilities, it certainly has no authority to require "enlargement" of production facilities, such as the drilling of additional wells, installation of

compression, etc., in order to maintain delivery capacity in a depleting gas field. The Court has overruled and reversed the only attempt ever made by the Commission to require a gas pipeline company involuntarily to enlarge its transportation facilities to prevent discrimination between customers, see *Panhandle Eastern Pipe Line Co. v. F.P.C.*, 204 F.2d 675 (3rd Cir. 1953). The veto authority of the Commission under Section 7(b) of the Act to prohibit abandonment of existing wells cannot be converted to an affirmative power to require the producer to make additional capital expenditures in order to maintain delivery capacity. If the existing wells are incapable of continuing the delivery capacity at prior levels, the Commission cannot require the producer to make capital expenditures in order to prevent a finding by the Commission that the producer is in violation of an obligation imposed upon him by a certificate condition. The limitation of jurisdiction on the Commission must override any attempt by the Commission to expand that jurisdiction through regulation.

C. An Attempt By The Commission To Regulate Production Operations By Imposing Delivery Requirements Would Interfere With Jurisdiction Now Being Exercised By State Conservation Agencies.

In the *Panhandle Eastern* and *Phillips I, supra,* the Supreme Court made it clear that the intention of Congress was to impose Commission jurisdiction only in areas which were not then subject to appropriate state regulation. In the *Panhandle Eastern* case, the Court dealt at length with the colloquy before the Congressional

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Committees pointing out that states had retained jurisdiction over production operations. Article III of the Interstate Oil Compact provides as follows:

> "Each State bound hereby agrees that within a reasonable time it will enact laws, or if laws have been enacted, then it agrees to continue the same in force, to accomplish within reasonable limits the prevention of:
>
> (a) The operation of any oil well with an inefficient gas-oil ratio.
>
> (b) The drowning with water of any stratum capable of producing oil or gas, or both oil and gas, in paying quantities.
>
> (c) The avoidable escape into the open air or the wasteful burning of gas from a natural gas well.
>
> (d) The creation of unnecessary fire hazards.
>
> (e) The drilling, equipping, locating, spacing or operating of a well or wells so as to bring about physical waste of oil or gas or loss in the ultimate recovery thereof.
>
> (f) The inefficient, excessive or improper use of the reservoir energy in producing any well.
>
> The enumeration of the foregoing subjects shall not limit the scope of the authority of any State."

Thirty-three of the fifty states, including practically all of the oil and gas producing states with the exception of

California, have become members of the Interstate Oil Compact Commission. Nearly all of these

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states have created a conservation agency to prevent waste of oil and gas and to protect the correlative rights of the owners of an oil and gas reservoir. Violation of the regulation of the State Conservation Agencies subjects the operator to severe penalties, see *e.g.*, Article 6036, *Vernon's Civil Statutes Annotated* (Texas) 1962 Revision. The rate of production of casinghead gas is controlled by the State Conservation Agency regulation over the rate of production of the associated oil. Therefore, a Commission order requiring the producer to continue to deliver quantities of casinghead gas could represent a square conflict with proration orders of the State Conservation Agency. State laws usually contain provisions setting out minimum spacing requirements for gas wells. Therefore, a Commission order which required the drilling of additional wells to maintain delivery requirements would violate the State's spacing regulations, and the producer would not be able to obtain a permit to drill the well. Moreover, the real inquiry made by the Commission as to whether the producer was meeting his delivery obligation imposed in a certificate, is to determine whether the producer is operating the field in a prudent manner. This is precisely the question which the State Conservation Agencies are set up to deal with, and which their regulation encompasses.

Since reservoir conditions vary depending upon a number of different physical factors, the state legislatures have generally established state regulatory commissions with

power to issue general and specific rules for drilling wells and regulating rates of production associated with the development of various oil and gas reservoirs and fields. A representative sampling of these agencies and the statutes creating them are as follows: Corporation Commission, State of Oklahoma 52 *Oklahoma Statutes* (1961) Sec. 274; Oil Conservation Commission, State of New Mexico, *New Mexico Statutes Annotated* (1953) 65-3-13, *et seq.;* Railroad Commission of Texas, *Vernon's Texas Civil Statutes Annotated* (1962) Art. 6049 C *et seq.;* The State Corporation Commission of Kansas, *Kansas Statutes Annotated,* 55-703 *et seq.;* Commissioner of Conservation, *West's Louisiana Statutes Annotated,* R.S. 30: 4 *et seq.;* Arkansas Oil and Gas Commission, *Arkansas Statutes,* Sec. 53-109 *et seq.*

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There is no question that state governments have the authority under their police powers to promote the conservation of natural resources within their borders. *Railroad Commission of Texas v. Rowan & Nichols,* 310 U.S. 573, 581, 60 S. Ct. 1021, 84 L.Ed. 1368 (1940); *Burford v. Sun Oil Co.,* 319 U.S. 315, 63 S. Ct. 1098, 87 L.Ed. 1424 (1943); *Brown v. Humble Oil & Ref. Co.,* 126 Tex. 296, 83 S.W.2d 935, 99 A.L.R. 1107 (1935); *F.C. Henderson, Inc. v. Railroad Commission of Texas,* 56 F.2d 218 (1932), appeal dismissed, 287 U.S. 672, 53 S. Ct. 4, 77 L.Ed. 579; *Gulf Land Co. v. Atlantic Ref. Co.* 134 Tex. 59, 131 S.W.2d 73 (1939); *Bernstein v. Bush,* 29 Cal. 2d 773, 177 P.2d 913 (1947); *People v. Associated Oil Co.,* 211 Cal. 93, 294 P. 717 (1930); *Kansas Neb. Natl. Gas Co. v. State Corporation Commission,* 169 Kan. 722, 222 P.2d 704 (1950); Childs v. *Washington,* 229 La. 869, 87 So. 2d 111 (1956); *Nunley v. Shell Oil Co.,* 76 So. 2d 111 (La. App. 1954), aff'd. 229 La. 349, 86 So. 2d 62 (1956); *Superior Oil Co. v. Foote,* 214 Miss. 857, 59 So. 2d 85, 844, 37 A.L.R. 2d 415 (1952); *Wood Oil Co. v. Corporation Commission,* 205 Okla. 537, 239 P.2d 1023 (1950); *Sylvania Corp. v. Kilborne,* 271 N.E.2d 524 (Ct. App. N.Y. 1971); 58 C.J.S. 618, 229 *et seq.*

If Congress had intended to take this jurisdiction away from the states and give it to the Commission, it would have clearly said so in the Natural Gas Act. On the contrary, it clearly through Section 1(b) of the Natural Gas Act, the production and gathering exclusion, indicated its intention to reserve this area to the State Conservation Agencies, and not to this Commission.

D. The Producer's Obligation To Act As A "Prudent Operator" Is Monitored By His Relationship With The Lessor-Royalty Owner.

A natural gas producer seldom owns the fee title to the land on which the wells are drilled. Instead he purchases an oil and gas lease from the landowner. The lease gives the producer-lessee the right to explore for and develop the property for oil and gas, with all other rights reserved to the lessor. One of the principal considerations flowing to the lessor is the receipt of the share of the oil and gas produced, called "royalty". The lease itself imposes a number of expressed covenants, restrictions, and conditions on the lessee's operations, and may require a specific drilling commitment.

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In addition, there is a large body of law in every major producing state which imposes certain "implied covenants" upon the lessee of an oil and gas lease by virtue of the fact that he is entitled to the sole control over the producing operations. As the primary benefit received by the lessor under the lease is his royalty in the oil and gas produced, many leases provide, and in cases where the leases do not so provide the Courts have implied, the following covenants against the lessee:

(1) To drill a well within a reasonable time, which time period can be extended by payment of a rental for "delay".

(2) To drill additional wells to protect the lease against underground drainage of oil and gas from wells drilled on adjacent leases.

(3) To fully develop an oil or gas reservoir on the land once it has been discovered.

(4) To diligently market the oil and gas once it is found.

The lessee is held to the standard of performance of an "ordinary prudent operator" and if he does not perform under these covenants, he is liable in damages to the lessor, and if the failure continues after due notice and opportunity to perform, the lease is subject to cancellation. A large number of cases supporting these propositions are cited in the Law of *Oil and Gas* by W.L. Summers, Volume 2, at pages 559-654, see also, Merill, *Covenants Implied in Oil and Gas Leases,* Thomas Law Book Company, 1940.

IV. The Commission Should Hear Oral Argument On The Requirements Of The Administrative Procedure Act Respecting Rulemaking.

As an additional reason for oral argument, the Commission should be apprised of the mandatory procedural

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requirements of the Administrative Procedure Act ("APA") which it failed to follow in this proceeding, thereby rendering substantive parts of Order No. 539 unlawful and of no effect.

As the Commission is aware, Order No. 539 was issued without prior notice or opportunity for comment by interested parties. The immediate substantive effect of the Commission's Order is the promulgation of Section 2.83 of the Rules, which purportedly accomplishes two purposes. First, the Section announced the Commission's intention to enforce gas contract obligations as certificated by the Commission. Secondly, the Commission promulgated Section 2.83(d) of the Rules which sets forth a certificate condition which will be included in the future in *all* temporary and permanent certificates of public convenience and necessity issued to producers. This certificate condition prescribes new substantive and procedural requirements, including new filing and reporting obligations, for independent producer jurisdictional gas sales. Order No. 539 also indicates that this substantive requirement will be imposed upon producers without further consideration by the Commission of reasons why such certificate condition should not be imposed with respect to a particular gas sale.

In promulgating Section 2.83(d) of the Rules, the Commission has failed to comply with the notice and comment requirements for informal rulemaking specified in the Administrative Procedure Act, 5 U.S.C. 551, *et seq*. The rulemaking standards of Section 553 of the APA in pertinent part are as follows:

> "b. General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—
>
> (1) a statement of the time, place, and nature of public rule making proceedings;

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> (2) reference of the legal authority under which the rule is proposed; and
>
> (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.
>
> Except when notice or hearing is required by statute, this subsection does not apply—
>
> (A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or
>
> (B) when the agency for good cause finds (and incorporates the finding in a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impractical, unnecessary, or contrary to public interest.

> (c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 of this title apply instead of this subsection."

The legislative history and judicial interpretation of the APA conclusively show that Section 553 was enacted to guarantee the public an opportunity to participate in the rulemaking process. With the limited stated

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exceptions noted above, an agency was directed by Congress to give public notice of a proposed rule and to grant interested parties an opportunity to present their views prior to the adoption of such rule, *Administrative Procedure Act: Analysis Of Its Requirement As To Rule-Making*, 33 A.B.A.J. 315 (1947). Further, not only was this requirement established to protect the rights of interested parties, but it was intended to permit an administrative agency to "educate" itself prior to establishing rules and procedures having a substantial impact on those persons and corporations it was charged with regulating, *Pacific Coast European Conference v. United States*, 350 F.2d 197, 205 (9th Cir. 1965), cert. denied, 382 U.S. 958 (1965). Section 553 was not enacted merely as a

record statute obligating the agency to give constructive notice to persons who did not have actual notice of certain agency rules, but rather it established procedures to be followed in order for an agency's rule to be given the force of law. If the agency does not follow these prescribed procedures, the rule is illegally issued and, consequently, ineffective, *Billy E. Graham v. Rufus B. Lawrimore,* 185 F. Supp. 761, 734-64 (E.D.S.C. 1960), affirmed, 287 F.2d 207 (4th Cir. 1961). See also, *Public Administrative Bodies and Procedure,* 73 C.J.S. § 94; *Texaco Inc. v. F.P.C.,* 412 F.2d 740 (3rd Cir. 1969).

From these authorities, it is abundantly clear that the overriding reason for adoption of Section 553 in the APA was to provide notice and hearing prior to governmental agencies prescribing new rules. There were provided, however, exceptions to this procedure if the issuance of the rule fell within the narrow boundaries of two exceptions. First, no notice or oportunity for comment is required by the APA prior to the issuance of an agency statement of general policy, interpretative rules or rules relating to the agencies organization, procedure or practice. Secondly, where good cause is found and reason therefor are stated in the order issuing a rule, notice and comments may be dispensed with if impractical, unnecessary or contrary to the public interest. The Commission in Order No. 539 made no

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attempt to demonstrate that its failure to provide notice and opportunity for comments was based upon the second of these exceptions, and therefore, we conclude that the Commission's legal justification, if any, for noncompliance with Section 553 of the APA is based upon the first exception, *i.e.,* the characterization of Section 2.83 (d) of the Rules as a statement of general policy. Therefore, the legality of the Commission's action apparently rests upon whether Section 2.83(d) can be fairly characterized as a statement of general policy or whether, in the alternative, it must be viewed as a substantive rule to which the notice and comment requirements of Section 553 of the APA apply.

The distinction between substantive rules on one hand and statements of general policy on the other is clearly expressed in the recent decision in *Pacific Gas and Electric Co. v. F.P.C.,* 506 F.2d 33, 38 (D.C. Cir. 1974) as follows:

> "The critical distinction between a substantive rule and a general statement of policy is the different practical effect that these two types of pronouncements have in subsequent administrative proceedings. . . . A properly adopted substantive rule establishes a standard of conduct which has the force of law. In subsequent administrative proceedings involving a substantive rule, the issues are whether the adjudicated facts conform to the rule and whether the rule should be waived or applied in that particular instance. The underlying policy embodied in the rule is not generally subject to the challenge before the agency.
>
> A general statement of policy, on the other hand, does not establish a 'binding norm.' It is not finally determinative of the issues or rights to which it is addressed. The agency cannot apply or

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> reply upon a general statement of policy. A policy statement announces the agency's tentative intentions for the future. When the agency applies the policy in a particular situation, it must be prepared to support the policy just as if the policy statement had never been issued. An agency cannot escape its responsibility to present evidence and reasoning supporting its substantive rules by announcing binding precedent in the form of a general statement of policy."

The firm and unequivocal requirements of Section 2.83(d) cannot be characterized as "merely an announcement to the public of the policy which the agency hopes to implement in future rulemakings or adjudications" (506 F.2d at 38). Based upon many orders already issued by the Commission, the certificate condition of Section 2.83(d) is being included universally, without substantial evidentiary support underlying the Commission's action in each case. Under the above-quoted criteria, the certificate condition of Section 2.83(d) is therefore being treated by the Commission as a substantive rule. Further, this certificate condition cannot be considered "minor, routine, insignificant, or unimportant" (506 F.2d at 43) which underscores its substantive nature. Patently the Commission's Section 2.83(d) cannot be viewed as a statement of general policy indicating the Commission's "tentative intentions for the future" (506 F.2d at 38). As it is being applied by the Commission, Section 2.83 (d) can only be characterized as a substantive rule, and not as a statement of general policy.

The issuance of Order No. 539 is clearly comparable to the issuance by the Commission of Order No. 362 in Docket No. R-230 (39 F.P.C. 412). There, the Commission, without notice or opportunity for comment, issued a rule requiring that monthly compound interest be paid upon refunds ordered in the future by the Commission. The Court of Appeals, in reversing Order No. 362 in *Texaco Inc. v. F.P.C.*, 412 F.2d 740 (3rd Cir. 1969) found that the Commission had failed to provide the requisite notice and opportunity for comments stating that:

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> "Section 553 was enacted to give the public an opportunity to participate in the rule-making process. It also enables the agency promulgating the rule to educate itself before establishing rules and procedures which have a substantial impact on those regulated." (412 F.2d at 744)

V. Conclusion

We believe that if the Commission had conformed with the requirements of Section 553 of the Administrative Procedure Act and obtained the views of interested parties, it would not now be laboring under the erroneous conceptions previously detailed in this Motion. Therefore, the Commission should grant oral argument for the pur-

pose of permitting parties to fully explain all of the ramifications of Order No. 539.

Respecfully submitted,

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VERIFICATION

THE STATE OF TEXAS §
COUNTY OF HARRIS §

THOMAS G. JOHNSON, being duly sworn, deposes and says that he is an attorney for Shell Oil Company; that he is authorized to verify and file this document; that he has examined the statements contained therein, and that all such statements are true and correct to the best of his knowledge, information and belief, and that he has been duly empowered and authorized to subscribe said instrument and to execute this verification on behalf of Shell Oil Company and each of the parties joining in said Motion for Oral Argument.

THOMAS G. JOHNSON
Thomas G. Johnson

Subscribed and sworn to before me, this 19th day of December, 1975.

DELIA GONZALEZ
Delia Gonzalez
Notary Public in and for
Harris County, Texas

My Commission Expires June 1, 1977.

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CERTIFICATE OF SERVICE

I hereby certify that I was advised on the 11th day of November, 1975 by the Office of the Secretary of the Commission that no service was required on any person other than the Commission, and that filing with the Secretary would constitute compliance with the requirement of Section 1.17 of the Rules of Practice and Procedure.

Dated at Houston, Texas, this the 19th day December, 1975.

THOMAS G. JOHNSON
Thomas G. Johnson

Of Counsel for

Shell Oil Company

* * *

[1]

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Richard L. Dunham, Chairman; Don S. Smith, John H. Holloman III, and James G. Watt.

	Docket Nos.
Natural Gas Pipeline Company of America, *et al.*	CP76-14, *et al.*
Tennessee Gas Pipeline Company	CP74-281
Southern Natural Gas Company and Mid-Louisiana Gas Company	CP75-367
The California Company, A Division of Chevron Oil Company	CI74-73
Mobil Oil Corporation	CI75-663
Amoco Production Company	CI75-697
Mobil Oil Corporation	CI76-53
Texaco Inc.	CI76-93
Mobil Oil Corporation	CI76-129
The California Company, A Division of Chevron Oil Company	CI76-177
Texaco Inc.	CI76-182
The California Company, A Division of Chevron Oil Company	CI76-183
Continental Oil Company	CI76-194
The California Company, A Division of Chevron Oil Company	CI76-201

Getty Oil Company	)	CI76-202
Burmah Oil Development, Inc.	)	CI76-209
Cities Service Oil Company	)	CI76-220
Mesa Petroleum Co.	)	CI76-223, CI76-273

FINDINGS AND ORDER GRANTING TEMPORARY AND PERMANENT CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY AFTER STATUTORY HEARING, SETTING HEARING, CONSOLIDATING PROCEEDINGS, GRANTING INTERVENTIONS, ACCEPTING RATE SCHEDULES FOR FILING, ORDER TO SHOW CAUSE AND RESCHEDULING PROCEDURES

(Issued January 26, 1976)

[2]

On November 21, 1975, the Commission issued an order in the consolidated proceedings *Natural Gas Pipeline Co. of America, et al.*, Docket Nos. CP76-14, *et al.*, granting temporary and permanent certificates and setting a hearing on three offshore projects in the Federal Domain, Gulf of Mexico. Seventeen additional dockets involving similar issues of fact and law are pending before the Commission in the above dockets. These proceedings will be treated in the same manner as the aforesaid *Natural* dockets. A minor change in the hearing order in the *Natural* dockets is also incorporated herein.

Amoco Production Company (Amoco) in Docket No. CI75-697 requests a temporary certificate to initiate sales of gas from Block 35 in the Block 14 Field Area, Vermillion Area, offshore Federal Domain, Gulf of Mexico, to

Trunkline Gas Company (Trunkline) at the national rate established in Opinion No. 699-H (51.0¢ per Mcf at 14.73 psia subject to upward and downward Btu adjustment from a base of 1,000 and a gathering allowance of 0.5¢ per Mcf) in lieu of the base contract rate of 65.0¢ (15.025 psia) and cites economic hardship as the basis for its temporary request. The related contract commits recoverable gas reserves lying between the Cibicides Opima No. 1 Sand (the base of which is encountered at a depth of 10,750 feet) and the base of the Cibicides Opima Nos. 4-5 Sand (found at 10,802 feet). Amoco's application was filed on May 16, 1975, and supplemented on July 28, 1975.

Amoco and Union Oil Co. of California each own 50 percent of the reserves in Vermillion Block 35; only Amoco has filed an application for sale of gas. Union, therefore, will be directed to file a statement advising the Commission of its intentions with regard to its interest.

Texaco Inc. (Texaco) in Docket No. CI76-93 requests a temporary certificate to initiate sales of gas from its interest in the Block 183 Field, Ship Shoal Area, Federal Domain, to Tennessee Gas Pipeline Company (Tennessee) at the national rate established in Opinion No. 699-H (51.0¢ per Mcf at 14,73 psia subject to upward and downward Btu adjustment from a base of 1,000 and a gathering allowance of 0.5¢ per Mcf) in lieu of the base contract rate of 80.0¢ (15.025 psia) and cites buyer's need for gas supplies to aid it in assuring the maintenance of adequate natural gas service, as the basis for its request. The related contract provides for a term of 5 years and limits the dedication to gas produced from all formations from the surface down to and including the

"D - 10" Sand (between the depths of 9,804 and 9,836 feet). In its application, Texaco states that all commercially producible natural gas reserves from the

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surface to the limit of each well bore in Block 183 are committed to the contract with Tennessee, that Texaco has not reserved any gas for its own use, and that there are no known natural gas reserves below the depth limitations contained in the contract. Texaco's application was filed on August 11, 1975, and supplemented on September 8, 1975.

Texaco in Docket No. CI76-182 requests a temporary certificate to initiate sales of gas from its interest in the Block 282 Field, Vermilion Area, Federal Domain, to Tennessee at the national rate established in Opinion No. 699-H (51.0¢ per Mcf at 14,73 psia subject to upward and downward Btu adjustment from a base of 1,000 and a gathering allowance of 0.5¢ per Mcf) in lieu of the base contract rate of 60.0¢ (15.025 psia) and cites economic hardship as the basis for such request. The related contract provides for a term of 10 years and limits the dedication to casinghead gas in all formations down to and including the Val H-2 reservoir at measured depths of 5,686 to 5,746 feet. In its application, Texaco states that all commercially producible natural gas reserves from the surface to the limit of each well bore in Block 282 are committed to the contract with Tennessee, that Texaco has not reserved any gas for its own use and that there are no known natural gas reserves below the depth limitations contained in the contract. Texaco's application was filed on September 26, 1975. As Texaco's contract

here has the same term as Mobil Oil Corporation's for the sale certificated to Trunkline in Docket No. CI75-538, in the order issued November 21, 1975, in *Natural Gas Pipeline Co., et al.*, the term of the contract is not in issue. The depth limit, however, remains an issue to be resolved, as hereinafter indicated, in both of Texaco's contracts.

By the order issued in *Natural* on November 21, 1975, the Commission stated that since a stated term in a sales contract cannot limit the dedication of that gas to such term, it would not reject contracts with terms of less than 20 years. In view thereof, the applications in Docket Nos. CI76-93 and CI76-182 will be granted on the basis that authorizations will be conditioned that all commercially producible reserves from the surface to the limit of each well bore in the Block 183 Field, Ship Shoal, and Block 282 Field, Vermilion Area are dedicated and that Texaco shall file contract amendments consistent therewith to eliminate any controversy over the difference between the certificate and rate schedule. Such condition will permit disposition of Texaco's applications pursuant to the statutory hearing procedure.

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Mobil Oil Corporation (Mobil) filed an application on September 2, 1975, in Docket No. CI76-129 and in Docket No. CI75-663 on May 7, 1975, as supplemented on July 24 and amended September 2, to initiate sales of gas from Main Pass Block 140, Federal Domain, Gulf of Mexico, to Southern Natural Gas Company (Southern) and Mid-Louisiana Gas Company (M-L). Mobil's contract provides for a term of 10 years and limits the dedi-

cation to zones presently above the base of the stratigraphic interval found at 9,490 to 9,565 feet. Mobil's contract provides for an initial rate of $1 per Mcf with annual periodic escalations and the price to increase to any higher national, area or other rate which may be prescribed or permitted. The Block 140 lease date is October 1, 1972. Mobil owns a 35 percent interest; Gulf Oil Corporation (Operator), owns a 45 percent interest; Pennzoil Offshore Gas Operators, Inc. (Pogo) owns a 10 percent interest; and Pennzoil's Louisiana and Texas Offshore, Inc. (Plato) owns a 10 percent interest. Gulf's interest in Block 140 is presently being sold to Texas Eastern Transmission Corporation and upon issuance and acceptance of a certificate for Mobil's sales to Southern and M-L, a balancing arrangement will be utilized to permit Mobil to recover volumes attributable to its interest. Mobil's facilities are presently being used to bring Gulf's gas onshore for delivery into its facilities to deliver the gas to Texas Eastern at the delivery point at the processing plant at Venice, Louisiana. Pogo and Plato have not made any arrangements for the sale of their interest. Mobil's contract dedicates the south half of Block 140 and further limits the dedication to only those zones present in the indicated intervals. Mobil has stated that it does not consider the north half of Block 140 to be productive. Pursuant to an advance payment arrangement dated April 11, 1975, M-L has made advance payments of $2 million; on April 18 Southern Natural assumed 40 percent of M-L's rights, obligations and privileges in the advance payment agreement.

Southern and M-L filed a joint application in Docket No. CP75-367 on June 13, 1975, as supplemented on

October 9, 1975, for the construction and operation of those facilities needed to receive the gas from Mobil and to exchange and transport the volumes to be purchased by M-L. On October 31, 1975, Southern and M-L requested a temporary certificate to permit the facilities to be constructed and placed in operation. Since Mobil will use its own facilities to deliver its own gas at an onshore point in South Louisiana, the

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Commission will also require Mobil to show cause why its facilities necessary for the sale of gas to Southern and M-L are not subject to the Commission's jurisdiction. See *Gulf Oil Corporation,* Docket No. CI76-105, order issued August 15, 1975; and *Getty Oil Company, et al.,* Docket No. CI75-516, *et al.,* order issued September 9, 1975.

Southern and M-L have entered into an exchange and transportation agreement to receive the gas which each will purchase from Mobil. M-L proposes to install a meter at a point in Plaquemines Parish, Louisiana, where Mobil will deliver Block 140 gas and to construct and operate the facilities to transport the gas from such point to a point on Southern's existing 16-inch pipeline near Grand Bay, Plaquemines Parish, Louisiana. At this point, Southern will receive its 40 percent of the gas which it purchases and M-L's 60 percent of the gas, which will be delivered to M-L by exchange in the Monroe Field, Ouachita Parish, Louisiana, presently being produced and sold by Ashland Oil Company to Southern, at an existing compressor station at Perryville or at the outlet of Ashland's Cargas compressor station. M-L and Southern an-

ticipate exchanging approximately 10,000 Mcf per day. The exchanges will be brought into balance as soon as operationally feasible. In the event Southern's Monroe Field deliveries are deficient, it will make additional deliveries to M-L in the Lake St. John Field, Concordia Parish. M-L may also make up deficiencies at the same delivery point. The term of the exchange and transportation agreement is ten years and thereafter for an additional term of five years. The proposed exchange it is asserted will provide M-L with the benefit of gas produced in the Gulf of Mexico without constructing extensive facilities. Southern will install and operate a tap on its existing 16-inch pipeline at Grand Bay Exchange Point. M-L's facilities consist of a meter at the Mobil delivery point, 3 miles of 6-inch pipeline, and additional short segments of pipe and rearrangement of minor facilities at the Perryville interconnection with Southern. M-L will also extend an existing Monroe Field line to the outlet of Ashland's Cargas compressor station. The estimated cost of facilities totals $280,000. The proposed three mile pipeline will parallel an existing pipeline and will not traverse any major rivers or highways. The ground cover along the right of way will be allowed to revegitate to existing marsh grass and bushes. None of the proposed facilities will be located or routed through any park, scenic, recreational, or wild life area. Thus, approval of this proposed project would not constitute a major Federal action significantly affecting the quality of the environment.

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The California Company, a Division of Chevron Oil Company (Chevron) on February 18, 1975, requested

that the conditioned temporary certificate issued on August 30, 1973, in Docket No. CI74-73, be amended to authorize additional sales from parts of four horizons in the Block 181 Field (Extension), West Cameron Area, Federal Domain, to Natural at the national rate established in Opinion No. 699-H (51.0¢ per Mcf at 14.73 psia subject to upward and downward Btu adjustment from a base of 1,000 and a gathering allowance of 0.5¢ per Mcf).

In Docket No. CI76-177, Chevron requested a temporary certificate on September 24, 1975, to initiate sales from the Block 172 Field (Extension A), West Cameron Area, Federal Domain, to Natural. Chevron states it is willing to accept a permanent certificate at the national rate. As the basis for its temporary request in Docket No. CI76-177, Chevron states that it has established production, has a large capitalized investment in the area and is prepared to commence deliveries immediately. In each instance, the related contract or amendatory agreement limits the dedication of Federal Domain reserves to specified horizons.

Concurrently with its petition to amend, Chevron submitted an agreement dated December 9, 1974, which amends a June 4, 1973, contract between it and Natural by adding parts of the 9,500 Foot Sand, the 9,700 Foot Sand, the 10,300 Foot Seg. A Sand and the 10,700 Sand underlying Blocks 172 and 181. Pursuant to the temporary certificate issued in Docket No. CI74-73 on August 30, 1973, Chevron is presently selling gas to Natural from the two producing horizons included in the 7,600 Foot and 7,750 Foot Sands underlying Blocks 172 and

181 dedicated to the June 4, 1973, contract which is one file as Chevron's Rate Schedule No. 78.

Concurrently with its application in Docket No. CI76-177, Chevron submitted a September 3, 1975, contract as the proposed related rate schedule. The contract provides for a term of 20 years and limits the dedication to the 7,600 Foot, 9,500 Foot and 10,300 Foot Sands underlying a specified portion of Block 172. Block 172 and the east half of Block 181 are subject to a December 12, 1970, Lease Funding Agreement, as amended. The west half of Block 181 is subject to an Exploration, Development & Production Advance Payment Agreement dated June 30, 1975.

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Mobil filed an application in Docket No. C176-53 on July 28, 1975, for the sale of gas from Blocks 532 and 533, West Cameron Area, Federal Domain, Gulf of Mexico to Natural. Chevron in Docket No. C176-201 on October 3, 1975, filed an application to sell gas to Natural from the same Field. Burmah Oil Development, Inc. (Burmah) on October 7, 1975, in Docket No. C176-209 and Mesa Petroleum Company (Mesa) in Docket No. C176-233 on October 16, 1975, filed applications to sell gas to Natural from Blocks 322 and 323, East Cameron Area, Federal Domain, Gulf of Mexico. Mesa in Docket No. C176-273 on November 13, 1975, filed an application to sell gas to Trunkline Gas Company. Mesa proposes to sell 75 percent of its interest in Blocks 522-523 to Natural and 25 percent to Trunkline and reserves no gas for its own use and provides for a term of 20 years for its sales to Natural and Trunkline. Stingray Pipeline Company

(Stingray) has pending an application for certificate in Docket No. CP75-329 for authorization to construct and operate facilities for Natural, Trunkline, and United Gas Pipeline Company (United). The related contracts of Burmah, Mobil and Chevron dedicate reserves found in specified sands or wells only. Mesa's contracts have no depth limitations and do not reserve any gas for its own use; therefore, in Docket No. C176-223 and C176-273, a permanent certificate may be issued to Mesa without a requirement for amendment of its contracts for the proposed sales of gas as they do not contain any limitations found to require a hearing. Chevron owns 100 percent working interest in Block 534 but has not filed for authorization to sell such gas. Chevron in its September 23, 1975, contract with Natural dedicates 75 percent of 75 percent of its interest in gas found in the 3200 feet - 3500 feet sands from wells to be produced from its "A" Platform and reserves the right to sell by separate contract 25 percent of 75 percent of its interest to Trunkline; however, Chevron has not filed the contract for such sale to Trunkline. Chevron has reserved the remaining 25 percent for itself. The contract dated June 18, 1975, between Mobil and Natural dedicates only the south half of Block 532 and the north half of Block 533, and further restrict the dedication to zones above the base of the strategraphic equivalent of the 3700 feet sand and the wells numbered A-1 through A-8. Each Block 532-533 contract provides that the producer may inject liquids into the pipeline system for transportation onshore; thus, Natural and Stingray will be required to make a filing of a tariff and supporting cost-of-service exhibit for the liquid service for Mobil and Chevron. Natural has made advance payments to Mobil for the South half of Block 532 and North half of Block

533, West Cameron Area. Chevron and Mobil each owned a 1/3 interest in each block; the remaining 1/3 is owned by Pogo and Plato. No contracts appear to have been executed or filed for the

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sale of their interest, although United has made advance payments to Pogo and Plato covering Blocks 532 and 533. Mesa's September 25, 1975, contract to Natural and October 28, 1975, contract to Trunkline commits 100 percent of its interest from any gas produced from Blocks 322-323. Burmah's September 18, 1975, contract with Natural commits 75 percent of its interest from the surface down to the base of the J-4 sand and from the southeast quarter of Block 322 and southwest quarter of Block 323 and provides that the remaining 25 percent of Burmah's interest will be sold by separate contract to Trunkline. Burmah, therefore will be directed to file a statement advising the Commission of its intentions with regard to its undedicated interest. Mesa owns 52 percent of the working interest and Burmah owns 48 percent working interest in Blocks 322-323, East Cameron Area. Burmah, and Mesa's contracts permit the producers to exercise an option to inject its liquid hydrocarbons into the pipeline for transportation onshore. The transporting piplines will be required to file liquid transportation rate schedules and a supporting cost of service. Natural has made advance payments to Mesa and Burmah for the Block 322 and 323 gas.

Continental Oil Company (Continental) filed an application on October 1, 1975, an corrected on October 22, 1975 for a temporary certificate in Docket No. CI76-194

and Getty Oil Company (Getty) and Cities Service Oil Company (Cities) request permanent certificates in Docket Nos. C176-202 and C176-220, respectively, to initiate sales from Block 45, Grand Isle Area, Federal Domain, to Tennessee at the national rate established in Opinion No. 699-H (51.0¢ per Mcf at 14.73 psia subject to upward and downward Btu adjustment from a base of 1,000 and a gathering allowance of 0.5¢ per Mcf). In support of its request for a temporary certificate, Continental's application states that the development of Block 45 is at the stage where Continental will be able to deliver some gas upon issuance of an acceptable certificate. By letter filed October 22, 1975, Continental advised that deliveries can commence only after the installation of producing and pipeline facilities and although the pipeline facilities are not expected to be installed until April 1976, due to the winter season, Continental does not wish to withdraw its temporary request. By letter filed October 28, 1975, Cities withdrew its request for a temporary certificate in view of Continental's letter.

[9]

Each of the three related contracts commit only those horizons from the surface to the base of the LN Sand (between the measured depths of 11,281 and 11,301 feet on the electrical log of OCS G-1582 Well No. A-2). In its application, Continental stated that there are no developed or presently known gas reserves below the committed depth. Cities states in its application there are presently no plans to attempt to further develop Block 45 by additional drilling. Each applicant owns a 25 percent interest in Block 45; the remaining 25 percent

interest is owned by Atlantic Richfield Company. Arco will file a statement of its intentions with regard to the sale of its interest in Block 45. By order issued July 25, 1974, in Docket Nos. CI74-526, *et al.*, the Commission dismissed previous applications which the subject producer filed for certificates which would authorize sales from the subject block at a rate of 47.0¢ per Mcf (15.025 psia).

Getty's contract provides that Tennessee will transport liquids without charge unless (1) the FPC requires that a charge be made or (2) the FPC refuses to permit buyer to recover in its jurisdictional rates any costs allocable to the transportation of such liquids. The Commission will require TGP to file an appropriate rate schedule 30 days prior to the date on which it initiates a liquid transportation service for the producers, together with a supporting cost of service exhibit.

On May 2, 1974, Tennessee filed an application in Docket No. CP74-281 for authorization to construct and operate approximately 2.56 miles of 4-inch pipeline at an estimated cost of $378,700 to attach the subject reserves of Continental, Cities and Getty.

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The California Company, a Division of Chevron Oil Company, (Chevron) in Docket No. CI76-183 requests a temporary certificate to initiate sales of gas to Natural Gas Pipeline Company of America (Natural) from the Block 28 Field (Extension A), West Cameron Area, Federal Domain, and estimates such sales will total 300,000 Mcf per month (15.025 psia). In support of

its request for a temporary certificate, Chevron states that it has a large capitalized investment in the area and that it is prepared to effect immediate deliveries of gas. Although the base contract rate is $1.44 per Mcf (15.025 psia), Chevron states it is willing to accept a permanent certificate conditioned to the national rate established in Opinion No. 699-H (51.0¢ per Mcf at 14.73 psia subject to upward and downward Btu adjustment from a base of 1,000 and a gathering allowance of $.5¢ per Mcf). The related contract limits the dedication to specified horizons and provides that seller has the right, exercisable 5 years from the date of initial delivery, to withdraw from sale and take for its own use up to 20 percent of the remaining recoverable reserves.

In the order issued November 19 in *Natural supra,* the Commission noted that natural gas producers sought Commission approval of contracts which limit the dedication of gas to specified producing formations, reserve specific portions of gas for their own use, or limit the sale of gas to specified percentages of available reserves and limit the term of their contracts for the sale of gas. In view of the national shortage of natural gas and the declining gas reserves of interstate pipelines, the Commission by order issued June 3, 1975, in *Getty Oil Company, et al.,* in Docket No. CI75-319, *et al.,* directed that a formal hearing be held to resolve similar issues of depth limitations and limitation on the term of the sale.

The order of June 3, 1975, in Docket Nos. CI75-319 *et al.* (p. 1) states:

> "This proceeding involves issues of limitations in gas sales contracts, between independent producers

and an interstate pipeline, for natural gas to be produced and sold from leases in the Federal Domain in the Gulf of Mexico, proposed to be certificated by the Federal Power Commission and accepted for filing.

The producer gas sales contracts would limit dedications to the base of defined producing formations for a limited term. In view of the national shortage of natural gas and the declining

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gas reserves of interstate pipelines, the Commission directs a formal hearing on these issues. Applicants shall, *interalia,* in their evidence address the question of whether the dedication of gas reserves to be connected from Federal Domain leases should not include all of the commercially producible gas reserves from the surface to the limit of the well bore."

Producers herein have proposed contracts limiting the term of the sale contract, reserving volumes of gas or percentages of total reserves or options to do so at their unilateral discretion, and containing depth limits.

In accepting 5 and 10 year limited-term contracts, as in Texaco herein, the Commission found that a properly conditioned certificate could be issued:

Cases[1] decided under the Natural Gas Act, lead

1. *City of Detroit v. Panhandle Eastern Pipeline Company,* 6 FPC 196, 204, affirmed, 143 F.2d 488, (8th Cir. 1944), affirmed, 324 U.S. 635 (1945); *Sunray Mid-Continent Oil Company v. FPC,* 364 U.S. 137, 156 (1960); *Hunt v. FPC,* 306 F.2d 334, 342 (5th Cir. 1962); *Panhandle Eastern Pipeline Company v. FPC,* 177 F.2d 942, 945 (6th Cir. 1949); *Michigan Consolidated Gas Company v.*

to the finding that when the Commission certificates a sale by a producer, and the gas begins to flow under the certificated authority, the certificated service authority is binding on both seller and buyer until such time as the Commission authorizes a change in the certificated service. The authorized service integrates the duty to continue to make the sale regardless of any contractual provision to the contrary.

In order to accommodate the various applicants involved in these offshore projects, the Commission will tender to the natural gas producers, in the alternative, temporary or permanent certificates. Where the producers accept permanent authorization pursuant to the certificates hereinafter issued, specific conditions will eliminate all controversial issues. This can be accomplished by the filing by each producer of a contract amendment consistent with these requirements.

[12]

The alternative tendered to each natural gas producer is a temporary certificate which sets the application of the independent producer for hearing and decision and permits gas sales to commence as the Commission has previously permitted in the *Getty Oil Company, et al.,* Docket No. CI75-319, *et al.* Each natural gas producer

Panhandle Eastern Pipeline Company, 173 F.2d 784, 789 (6th Cir. 1949); *Continental Oil Company,* 31 FPC 1079, 1083, affirmed, 385 U.S. 83 (1966); *Cities Service Gas Company,* 38 FPC 364, 378 (1967); *Blair-Vreeland,* Opinion Nos. 724 and 724-A (1975); *Mitchell Energy Corporation,* Opinion No. 733 (1975); *El Paso Natural Gas Company, et al.,* Opinion No. 737 (1975).

therefore has the option of accepting a temporary certificate to commence operations and proceed to formal hearing on the issues raised by its contract for the sale of gas, or in the alternative accept a permanent certificate as conditioned and conclude action on its application.

By subsequent notice, the Secretary of the Commission will designate the applicants and Docket Nos. which will be the subject of the hereinafter scheduled hearing. Natural gas producers which accept neither permanent nor temporary authorization pursuant to this order will have their application set for hearing as part of the consolidated proceeding.

Petitions to intervene have been filed by Tennessee Gas Pipeline Co., Shell Oil Company, Public Service Commission of New York, and Southern Natural Gas Co.

At a hearing held on , 1975, the Commission on its own motion received and made a part of the record in these dockets all evidence, including the applications, as supplemented and amended, and exhibits thereto, submitted in support of the authorizations sought herein, and upon consideration of the record,

The Commission finds:

(1) Each Applicant herein is a "natural-gas company" within the meaning of the Natural Gas Act as heretofore found by the Commission.

(2) The sale of natural gas hereinbefore described, as more fully described in the application will be made in interstate commerce subject to the jurisdiction of the Commission; and such sale by Applicant, together with the construction and operation of any facilities subject

to the jurisdiction of the Commission necessary therefor, are subject to the requirements of Subsections (c) and (e) of Section 7 of the Natural Gas Act.

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(3) It is necessary and appropriate in carrying out the provisions of the Natural Gas Act that the FPC gas rate schedule related to the authorizations hereinafter granted should be accepted for filing.

(4) Participation by petitioners to intervene may be in the public interest in the proceedings in which they have filed petitions.

(5) The sales of natural gas hereinbefore described and as more fully described in the applications of natural gas producers in these dockets will be made in interstate commerce subject to the jurisdiction of the Commission, and such sales by said persons, together with the construction and operation of any facilities subject to the jurisdiction of the Commission necessary, therefore, are subject to the requirements of subsection (c) and (e) of Section 7 of the Natural Gas Act.

The Commission orders:

(A) Permanent certificates of public convenience and necessity are issued upon the terms and conditions of this order authorizing the sale by natural gas producer applicants, herein of natural gas in interstate commerce for resale for ultimate public consumption, together with the construction and operation of any facilities subject to the jurisdiction of the Commission necessary therefor, subject to Opinion No. 699, as amended, and any further orders

issued thereunder, conditioned to the lesser of the contract rate or the national base rate of 51.0 cents per Mcf (14.73 psia) (52.0¢ per Mcf if deliveries commence on or after 1/1/76), subject to upward and downward Btu adjustment from a base of 1,000 Btu per cubic foot, plus a 0.5 cent per Mcf gathering allowance, all as hereinafter described and as more fully described in the applications in said dockets, subject to the following conditions.

(B) All petitioners to intervene are permitted to intervene in all the proceedings in which they have filed petitions to intervene subject to the rules and regulations of the Commission; *provided, however,* that participation by such interveners shall be limited to matters affecting asserted rights and interests as specifically set forth in the petitions to intervene; and, *provided, further,* that the admission of such interveners shall not be construed as recognition by the Commission that they might be aggrieved, because of any order of the Commission entered in these proceedings.

[14]

(C) The certificates issued in paragraph (A) and (H) shall be void and without force or effect unless accepted in writing by Applicants within 30 days from the issue date of the order issuing such certificates; Provided, however, that if an application for rehearing of such order is filed in accordance with Section 19 of the Natural Gas Act, such acceptance shall be filed within 30 days from the issue date of the order of the Commission upon the application for rehearing or within 30 days from the date on which such application may be deemed to have been

denied when the Commission has not acted on such application within 30 days after it has been filed; *Provided, further,* that if a petition for review is filed in accordance with the provisions of Section 19 of the Natural Gas Act, such acceptance shall be filed within 30 days after final disposition of the judicial review proceedings thus initiated.

(D) The certificates issued in paragraph (A) and (H) above and the rights granted thereunder are not transferable and shall be effective only so long as Applicants continue the acts or operations hereby authorized in accordance with the provisions of the Natural Gas Act and the requirements, rules, and regulations of the Commission.

(E) The grant of the certificates issued in paragraph (A) and (H) shall not be construed as a waiver of the requirements of Section 4 of the Natural Gas Act or of Part 154 or Part 157 of the Commission's Regulations thereunder and is without prejudice to any findings or orders which have been or which may hereafter be made by the Commission in any proceeding now pending or hereafter instituted by or against Applicants. Further, our action in this proceeding shall not foreclose or prejudice any future proceedings relating to the operation of any price or related provisions in the gas purchase contracts herein involved. The grant of the certificates herein for service to the particular customers involved shall not imply approval of the terms of the contracts, particularly as to the cessation of service; termination must be pursuant to Section 7(b) of the Natural Gas Act. The grant of the certificates herein shall not be construed to preclude the imposition of any sanctions pursuant to provisions of the Natural Gas Act for the unauthorized commencement of any sale of natural gas subject to said certificates.

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(F) Applicants, upon acceptance of a permanent certificate in paragraph (A) above shall within 30 days of said acceptance file with the Commission an amendment to its gas sale contract to delete any reservation of gas from its own use and to dedicate all of the commercially producible gas reserves from the surface to the limit of the well bore.

(G) Section 154.93 of the Regulations under the Natural Gas Act is hereby waived to permit the inclusion in Applicants rate schedules of the contractual provision for rate increases to a higher area rate found to be proper by hearing, rule-making or a Commission approved settlement and the reimbursement by buyer of any excess royalty payments. Such waiver should not be construed as meaning that any rate increase based on such pricing provision would be accepted for filing without suspension.

(H) Based upon the allegations presented upon the need for additional natural gas supplies, the Commission finds that an emergency exists and temporary certificates are hereby issued to natural gas producer applicants herein pursuant to Section 7 of the Natural Gas Act authorizing the sale by Applicants in these docket of natural gas in interstate commerce for resale for ultimate public consumption, together with the construction and operation of any facilities subject to the jurisdiction of the Commission necessary therefor, subject to Opinion No. 699, as amended, and any further orders issued thereunder, conditioned to the lesser of the contract rate or the national base rate of 51.0 cents per Mcf (14.73 psia), (52.0¢ per Mcf if deliveries commence on or after 1/1/76), subject to upward and downward Btu adjustment from a

base of 1,000 Btu per cubic foot, plus a 0.5 cent per Mcf gathering allowance, subject to conditions stated above and hereafter.

(I) Applicants acceptance or rejection of the temporary certificates shall be filed within 30 days of the date hereof. If accepted, the temporary certificate shall be effective upon the date of receipt of the acceptance by the Secretary. Service under the temporary certificate shall commence within 30 days from the date of completion of the facilities by the purchaser or transporter. Such service shall be continued unless or until abandonment authorization is granted pursuant to Section 7(b) of the Natural Gas Act whether the contract term has expired or not. The issuance of temporary certificate and the acceptance of the rate schedule are without prejudice to such final disposition of the application for certificate as the record may require.

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(J) The applications in Docket Nos. CP74-281, CP75-367, CI76-194, CI76-202, CI76-220, CI76-53, CI76-201, CI76-209, CI76-201, CI76-209, CI75-663, CI76-129, CI 74-73, CI76-177, CI75-697, CI76-93, CI76-182, and CI 76-183 are hereby consolidated for hearing and decision with CP76-14, *et al.* By subsequent notice, the Secretary of the Commission will delete herefrom each application which is concluded by acceptance of a permanent certificate issued by paragraph (A) above.

(K) On or before February 26, 1976, Applicants and all persons in support shall each file their prepared testimony and exhibits comprising their case-in-chief, and in compliance with paragraph (N) below upon all parties

to the proceeding, the Office of the Administrative Law Judges, the Commission Staff and all parties to the consolidated proceeding.

(L) A Presiding Administrative Law Judge to be designated by the Chief Administrative Law Judge for that purpose (See Delegation of Authority, 18 CFR 3.5 (d)) shall preside at the hearing in this proceeding, with authority to establish and change all procedural dates, and to rule on all motions (with the sole exception of petitions to intervene, motions to consolidate and sever, and motions to dismiss, as provided for in the Rules of Practice and Procedure).

(M) Pursuant to the authority of the Natural Gas Act particularly Sections 7, 14, 15, 16 thereof, the Commission's Rules of Practice and Procedure, and the Regulations under the Natural Gas Act (18 CFR Chapter 1), a public hearing shall be held commencing March 22, 1976, at 10:00 a.m. (EST) in a hearing room at the Federal Power Commission, 825 North Capitol Street, N.E., Washington, D. C. 20426, concerning the matters in these consolidated dockets, at which time, *inter alia*, applicant's witnesses shall be presented in support of prepared evidence as detailed in paragraph (N) below.

(N) Each natural gas producer shall present as part of its prepared evidence in the consolidated hearing supporting data to show: Schedule I, the volumes of natural gas to be produced and sold from each field in which it has an interest during the term of its contract from contractually specified formations; Schedule II, the estimated gross and net recoverable natural gas reserves in each formations in each field; Schedule III the estimated gross and net recoverable natural

gas reserves commercially producible from the surface to the limit of the well bore; and Schedules IV, V and VI, deliverability schedules related to each of the reserve estimates called for above. Each natural gas producer shall also present a schedule of payments received and anticipated to be received from the interstate pipeline company proposing to purchase gas from the field. In order to reduce the volume of evidence submitted, a natural gas producer having an undivided interest in the Field may adopt the evidence of another producer as showing its reserves and deliverability.

(O) The rate schedules and rate schedule supplements related to the authorizations granted herein are accepted for filing to become effective on the date of initial delivery. Applicants shall advise the Commission of said date within 10 days thereof.

The rate schedules have been designated as follows:

Description	*Designation*
Contract 4-7-1975	Amoco Production Co., R.S. 706
Contract 8-1-1975	Texaco Inc., R.S. 528
Contract 9-15-1975	Texaco Inc., R.S. 529
Contract 9-2-1975	The California Co., A Division of Chevron Oil Company, R.S. 91

Contract 4-11-1975 Assignment 4-18-1975 (sale to M-L)	Mobil Oil Corp. R.S. No. 512 and Supp. No. 1
Contract 4-11-1975 Assignment 4-18-1975 (sale to Southern)	Mobil Oil Corp. R.S. No. 513 and Supp. No. 1
Contract 6-18-1975	Mobil Oil Corp. R.S. No. 514
Contract 9-23-1975 Agreement 6-26-1973	The California Company, a Division of Chevron Oil Company, R.S. No. 93, and Supp. No. 1
Contract 9-18-1975	Burmah Oil Devel., Inc. R.S. No. 4

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Contract 9-25-1975	Mesa Petroleum Co., R.S. No. 70
Contract 10-28-1975	Mesa Petroleum Co., R.S. No. 71
Agreement 12-9-1974	The California Company, a Division of Chevron Oil Co., R.S. No. 78, Supp. No. 4
Contract 9-3-1975	The California Company, a Div. of Chevron Oil Co., R. S. No. 92
Contract 9-17-1975	Continental Oil Co., R. S. No. 425

Contract 10-1-1975	Cities Service Oil Co., R. S. No. 429
Contract 9-4-1975	Getty Oil Co., R. S. No. 215

(P) Applicant natural gas company's attention is directed to Commission Order No. 539, issued October 14, 1975, F.R. , and to the provisions of Section 2.83 General Policy and Interpretations, 18 CFR 2.83. Moreover, issuance of this certificate authorization is conditioned to require Applicant, within 30 days of the initial reserve determination or any subsequent redetermination thereof, to report the results of each such initial or redetermination study to the Commission. The certificated minimum daily delivery obligation of the seller (1) shall be determined in accordance with applicable provisions specifically set forth in seller's contract unless otherwise changed by the certificate authorization; (2) shall be without regard to any contractual reservations contrary to the certificate authorization; (3) and shall remain in full force and effect unless and until changed by appropriate certificate authorization amendment based upon Applicant's full documentation of, *inter alia*, the reasons for any such proposed amendment, the sales production history, the amount of remaining connected reserves of Applicant dedicated under the contract and the status of Applicant's nondeveloped reserves dedicated under the contract. The certificate authorization is further conditioned to require that Applicant, if it has not secured an appropriate certificate amendment and there are circumstances resulting in the delivery of a lesser quantity of natural gas than any

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certificated delivery obligation, Applicant shall file for each contract year quarter, a verified report setting out the circumstances of such lesser deliveries and the corrective actions which Applicant proposes to undertake in order to meet any experienced delivery deficiency, such verified reports to be filed within 10 calendar days after expiration of each contract year quarter.

(Q) Certificates issued by this order to natural gas producers and gas begins to flow under such authority makes the certificated service authority binding on both seller and buyer until such time as the Commission authorizes a change in the certificated service regardless of any contractual provision to the contrary.

(R) Southern, M-L, Trunkline, Natural and TGP shall file within 45 days after service commences under the certificates issued herein, a verified statement showing *pro forma* Form 15 gas reserves and deliverability schedules for these fields, and representations of reserves controlled which will be made to stockholders, or contained in prospectus or registration statement in connection with financial reporting.

(S) Acceptance of the rate schedules of Applicants herein pursuant to temporary authorization in paragraph (H) does not constitute Commission approval of the contractual reservations or limitations involved pending resolution of the matter on the merits after hearing and decision. Appropriate authorization from the Commission is required by any pipeline to transport any gas which the producers may be permitted to reserve.

(T) Within 30 days from the date of this order, ap-

plicant in Docket No. CI75-697 shall file statement demonstrating the applicability of the rate, terms and conditions of Opinion No. 699-H, including the written waiver required by Section 2.56a(i) of the rules. If such statement is filed with the Secretary within 30 days, the rate may be made effective as of the date of initial delivery.

(U) Within 30 days from the date of this order, applicants in Docket Nos. CI76-223 and CI76-273 shall file the written waiver required by Section 2.56a(i) of the rules. If such waiver is filed within 30 days, the rate may be made effective as of the date of initial delivery.

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(V) Within 30 days from the date of the order each producer-applicant shall file three copies of a revised billing statement which clearly reflects the components of the authorized rate, namely, base rate, Btu adjustment and gathering allowance.

(W) Temporary certificates are issued to Applicants, Tennessee Gas Pipeline Company, a Division of Tenneco Inc. Southern Natural Gas Company and Mid-Louisiana Gas Company to construct and operate the subject facilities as hereinbefore described, all as more fully described in the applications, as amended and supplemented. The certificates are conditioned upon each producer-applicant herein receiving and accepting permanent or temporary Commission authorization to sell gas as applicable to each pipeline project. This authorization is without prejudice to such ultimate disposition of the applications, as amended and supplemented, as the record may require.

(X) The certificates issued in paragraph (W) above and the rights granted thereunder are conditioned upon Applicants' compliance with all applicable Commission Regulations under the Natural Gas Act and particularly the general terms and conditions set forth in paragraphs (c)(1), (c)(3), (c)(4), (e), (f) and (g) of Section 157.20 of such Regulations. The construction authorized shall be completed within one year from the date of this order in accordance with paragraph (b) of Section 157.20 of the Regulations.

(Y) Ordering paragraphs (N) (P) and (R) of the orders issued November 21, 1975, in *Natural Gas Pipeline Co., et al.*, Docket Nos. CP76-14, et al., are hereby amended to conform to order paragraphs (K), (M) and (N) herein.

(Z) The Secretary of the Commission is directed to serve a copy of this order on Union Oil Co. of California, which shall file a written statement within 15 days of the date of this order advising the Commission of its intentions with regard to its interest in Federal Domain Block 35 Vermillion Area; Pennzoil Offshore Gas Operators, Inc. and Pennzoil Louisiana and Texas Offshore, Inc., Block 140 Main Pass; Atlantic Richfield Co. as to its interest in Block 45 Grand Isle; Chevron as to its interest uncommitted in Blocks 322-323 East Cameron.

[21]

(AA) Mobil shall show cause why its pipeline facilities between Main Pass Block 140 and the delivery point to Mid-Louisiana Gas Company should not be subject to the requirements of Section 7 of the Act. A response is required of Mobil as part of its prepared evidence. No other response is required.

(BB) Within 30 days from the date of this order, applicants in Docket Nos. CI75-663, CI76-53 and CI76-129 shall file a statement demonstrating the applicability of the rate, terms, and conditions of Opinion No. 699-H. If such statement is filed with the Secretary within 30 days, the rate may be made effective as of the date of initial delivery.

(CC) The certificate authorization to pipelines herein to construct and operate facilities is conditioned on the cost of such facilities not becoming part of its rate base until such time as these facilities are operational and the producers proposing to sell gas to each pipeline company has accepted authorization to sell gas. TGP, Trunkline, Natural and Stingray Pipeline shall file appropriate rate schedules 30 days prior to the initiation of any transportation service for natural gas producers for the transportation of liquids from these fields, together with a supporting cost-of-service exhibit.

(DD) Amoco, Chevron, and Continental shall file copies of all operating agreements in these Fields so long as certificates are not issued and accepted by Union Oil, Pogo, Plato, Atlantic, Chevron, and Burmah, as applicable to their respective field operations herein.

By the Commission. Commissioner Watt, concurring, filed a separate statement appended hereto.

(SEAL)

MARY KIDD PEAK,
Acting Secretary.

[1]

Natural Gas Pipeline Company of America, *et al.*)Docket No. CP76-14, *et al.*

(Issued January 26, 1976)

WATT, Commissioner, *concurring:*

Commissioner Smith, on June 3, 1975, dissented in the Getty Oil Company case, lead Docket No. CI75-319, and on November 21, 1975, in the Natural Gas Pipeline Company of America case, lead Docket No. CP76-14 (the docket number before us.) He properly raised questions about the authorities of the Federal Power Commission to restrict or expand in individual initial sale certification applications the obligations of the producers. I share some of the concerns he voiced.

These matters, however, can best be addressed at such time as formal hearings have been held and the issues presented to the Commission within the context of an evidentiary record.

I am concerned on yet another issue embodied in this Order. On November 28, 1975, the Commission issued an Order granting reconsideration of Order No. 539. There are several policy and legal questions surrounding Order No. 539 that must be addressed by this new Commission. Because of these questions, I have reservations regarding the advisability and thrust of including requirements from Order No. 539, (Sec. 2.83 of the Commission's General Policy and Interpretations) in certificates.

To pursue the specific of these issues at the present time could cause delays in introducing new sources of natural gas to the interstate market. At a time of shortages and curtailments, we cannot afford this risk. Therefore, I concur in this decision and look forward to the Commission's resolution of these issues.

/s/ JAMES G. WATT
Commissioner

[1]

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Richard L. Dunham, Chairman; John H. Holloman III, and James G. Watt

	Docket Nos.
Natural Gas Pipeline Company of America, *et al.*	CP76-14, et al.
Bethlehem Steel Corporation	CI76-190
Florida Gas Exploration Company	CI76-192
Dorchester Exploration, Inc.	CI76-193
Shell Oil Company	CI76-225
Mitchell Energy Offshore Corporation, *et al.*	CI76-244
Case-Pomeroy Oil Corporation	CI76-317
Felmont Oil Corporation	CI76-318
Atlantic Richfield Company	CI76-357
Stingray Pipeline Company	CP75-329

FINDINGS AND ORDER GRANTING TEMPORARY AND PERMANENT CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY AFTER STATUTORY HEARING, SETTING HEARING CONSOLIDATING PROCEEDINGS, GRANTING INTERVENTIONS AND ACCEPTING RATE SCHEDULES FOR FILING

(Issued February 12, 1976)

On November 21, 1975, and January 26, 1976, the Commission issued orders in the consolidated proceeding

Natural Gas Pipeline Co. of America, et al., Docket Nos. CP76-14, *et al.*, granting temporary and permanent certificates and setting a hearing on offshore projects in the Federal Domain, Gulf of Mexico. Nine additional dockets involving similar issues of fact and law are pending before the Commission in the above dockets. These proceedings will be treated in the same manner as the aforesaid *Natural* dockets.

Bethlehem Steel Corporation, filed an application in Docket No. CI76-190 on September 30, 1975, for a sale of gas to Transcontinental Gas Pipeline Corporation from South Timbalier Block 185 Field, Federal Domain, at the

[2]

National rate. Its contract dated January 15, 1973, is for a term of 20-years and commits to the sale gas to be produced from formations down to 16,000 feet only. An identical contract was submitted by Florida Gas Exploration Company in Docket No. CI76-192; by Dorchester Exploration Inc. in Docket No. CI76-193; and by Mitchell Energy Offshore Corporation, *et al.*, in Docket No. CI76-244, filed on October 29, 1975. The Block 185 Field consists of Blocks 180, 181, 184, and 185 in the South Timbalier Area. The above four applications cover 47 percent of the working interest in Block 180, 181, 184. C&K Petroleum Inc. and H. C. Price Company, respectively, have small producer certificates in CS71-1102 and CS76-287 (24.9 percent in such blocks) and are signatory parties to the January 15, 1973, contract with Transco. CNG Producing Company and Shepherd Offshore Ventures own the remaining working interest in Blocks 180, 181, and 184. Shepherd is a signatory party

to the January 15, 1973, contract but has not filed an application of the sale of its interest in these three Blocks. CNG is authorized in Docket No. CI75-513 to sell gas to Consolidated Gas Supply Corporation from its 25 percent interest in Block 184, but not from its 25 percent interest in Block 180 and 181. The four applicants above own 25 percent of the working interest in Block 185. CNG is further authorized in Docket No. CI75-513 to make sales from its 15 percent interest in Block 185 to Consolidated and 14.6 percent is owned by three small producer certificate holders (H.C. Price Co., C&K Petroleum, Inc., and Furth Oil Co.), signatory parties to the January 15, 1973, contract. In addition, Shepherd and Zapata Corp. are signatory to the contract owning an interest in Block 185 and have not filed for authorization to make sales from their interest. The remaining interest is owned by Atlantic Richfield Company (20 percent), and Skelly Oil Company (20 percent), neither of which has filed a certificate application. Facilities from Block 185 Field to Block 179 Field were installed by Transco under its budget authorization to attach the Field to an existing pipeline of Trunkline Gas Company; and in Docket No. CP76-78, et al., Trunkline was authorized to transport up to 11,200 Mcf per day for Transco and 3,700 Mcf per day for Consolidated from Block 179 to a onshore point. As in prior orders in this proceeding, the Commission will require the operator of Block 185 Field to file operating agreements so that the Commission will be informed of the status of production as it may relate to non-certificated interest owners in the Field. Each interest owner which has not filed a certificate application will file a statement of its intention.

The contract between Transco and the producers dated January 15, 1973, provides that the price may increase as provided in paragraph (3) of Article XI, a provision which

[3]

constitutes a favored nation clause, which is impermissible in contracts dated after April 3, 1961, pursuant to Section 154.93 of the Regulations. The certificates issued by this order will be conditioned upon submittal by each applicant of a contract amendment eliminating such impermissible pricing provisions. Producers have also reserved the right to inject liquids into the pipeline facilities for transportation onshore at a charge of 20¢ per barrel, such to change if the Commission prescribes a different rate. Pursuant to prior Commission orders, Trunkline and Transco will be required to submit a supporting cost-of-service exhibit and tariff prior to initiation of such liquids transportation service.

Shell Oil Company in Docket No. CI76-225 filed an application on October 16, 1975, for the sale of gas to Natural Gas Pipeline Company from Vermilion Block 321, Federal Domain. Shell's contract reserves up to 25 percent of its reserves for its own use, provides for a term of 15 years and limits dedication of specified sands in its contract of August 1, 1975. The limits are specifically from the top of the "D" Sand to the base of the "S" Sand in a specified portion of Vermilion Block 321. Gas to be purchased by Natural will be received through facilities of Stingray Pipeline Company. Shell also reserved the right to transport its liquids through these facilities and thus Stingray will be required to submit a

cost-of-service exhibit and tariff prior to the initiation of transportation for Shell. Vermilion Block 321 is the subject of the advance payment agreement dated April 19, 1971.

Case-Pomeroy Oil Corporation filed an application in Docket No. CI76-317 on December 29, 1975, to initiate a sale to Columbia Gas Transmission Corporation from West Cameron Block 543, Federal Domain. C-P's contract dated December 15, 1975, has a term of 15 years, limits dedication to specified depths underlying a portion of Block 543, and reserves up to 25 percent of the gas for C-P's own use. Felmont Oil Corporation filed an identical contract covering its interest in Block 543 in Docket No. CI76-318. The specific depth dedication is from the surface to a true vertical depth of 12,305 feet. C-P and Felmont reserve the right to inject liquid hydrocarbons into the pipelines for transportation onshore. Columbia Gulf has made advance payments to C-P and Felmont covering their interest in Block 543.

[4]

Atlantic Richfield Company filed an application on January 26, 1976, in Docket No. CI76-357 for the sale of gas to Tennessee Gas Pipeline Company from Grand Isle Block 45, Federal Domain. The contract between Richfield and Tennessee provides for a term of 20 years and commits horizons between the surface in the base of the LN Sand in Block 45. The other 75 percent interest in this Block has been dedicated by Continental, Getty and Cities Service, in the order issued herein on January 26, 1976. Richfield's contract provides that Tennessee will transport liquids for Richfield without charge

unless the Commission requires the charge be made or the Commission refuses to permit Tennessee to recover in its jurisdictional rates allocable to the cost of the transportation of such liquids. The Commission will require Tennessee to make a cost-of-service and tariff filing as previously required.

Stingray Pipeline Company (Stingray) on May 6, 1975, filed an application in Docket No. CP75-329 to construct approximately 12 miles of offshore pipeline, namely 5.0 miles of 12¾ inch diameter lines to connect Block 533 Field West Cameron and 7.1 miles of 6⅝ inch diameter pipeline to connect East Cameron Block 322 Field to its existing offshore system and estimated total cost of $5,100,000. These facilities are to be constructed to attach additional reserves in West Cameron Block 533 Field and East Cameron Block 322 Field to transport gas for Natural Gas Pipeline, Trunkline, and United Gas Pipeline. A temporary certificate has been issued to Stingray to construct these facilities by separate order of the Commission. The Producer applications related to Stingray's facilities are in Docket Nos. CI76-53, CI76-201, CI76-209, CI76-273, and CI75-223 which are consolidated in this proceeding and Stingray's application should be consolidated with the other related matters herein for final determination by the Commission on a consolidated record.

[5]

In the order issued November 21, 1975, in *Natural, supra,* the Commission noted that natural gas producers sought Commission approval of contracts which limit the dedication of gas to specified producing formations,

reserve specific portions of gas for their own use, or limit the sale of gas to specified percentages of available reserves and limit the term of their contracts for the sale of gas. In view of the national shortage of natural gas and the declining gas reserves of interstate pipelines, the Commission by order issued June 3, 1975, in *Getty Oil Company, et al.*, in Docket No. CI75-319, *et al.*, directed that a formal hearing be held to resolve similar issues of depth limitations and limitation on the term of the sale.

The order of June 3, 1975, in Docket Nos. CI75-319 *et al.* (p. 1) states:

> "This proceeding involves issues of limitations in gas sales contracts, between independent producers and an interstate pipeline, for natural gas to be produced and sold from leases in the Federal Domain in the Gulf of Mexico, proposed to be certificated by the Federal Power Commission and accepted for filing.
>
> The producer gas sales contracts would limit dedications to the base of defined producing formations for a limited term. In view of the national shortage of natural gas and the declining gas reserves of interstate pipelines, the Commission directs a formal hearing on these issues. Applicants shall, *inter alia*, in their evidence address the question of whether the dedication of gas reserves to be connected from Federal Domain leases should not include all of the commercially producible gas reserves from the surface to the limit of the well bore."

Producers herein have proposed contracts limiting the term of the sale contract, reserving volumes of gas or

percentages of total reserves or options to do so at their unilateral discretion, and containing depth limits. By the order issued in *Natural* on November 21, 1975, the Commission stated that since a stated term in a sales contract cannot limit the dedication of that gas to such term, it would not reject contracts with terms of less than 20 years. In accepting 5 and 10 year limited-term contracts, the Commission

[6]

found that a properly conditioned certificate could be issued:

> Cases[1] decided under the Natural Gas Act, lead to the finding that when the Commission certificates a sale by a producer, and the gas begins to flow under the certificated authority, the certificated service authority is binding on both seller and buyer until such time as the Commission authorizes a change in the certificated service. The authorized service integrates the duty to continue to make the sale regardless of any contractual provision to the contrary.

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1. *City of Detroit v. Panhandle Eastern Pipeline Company*, 6 FPC 196, 204, affirmed, 143 F.2d 488, (8th Cir. 1944), affirmed, 324 U.S. 635 (1945); *Sunray Mid-Continent Oil Company v. FPC*, 364 U.S. 137, 156 (1960); *Hunt v. FPC*, 306 F.2d 334, 342 (5th Cir. 1962); *Panhandle Eastern Pipeline Company v. FPC*, 177 F.2d 942, 945 (6th Cir. 1949); *Michigan Consolidated Gas Company v. Panhandle Eastern Pipeline Company*, 173 F.2d 784, 789 (6th Cir. 1949); *Continental Oil Company*, 31 FPC 1079, 1083, affirmed, 385 U.S. 83 (1966); *Cities Service Gas Company*, 38 FPC 364, 378 (1967); *Blair-Vreeland*, Opinion Nos. 724 and 724-A (1975); *Mitchell Energy Corporation*, Opinion No. 733 (1975); *El Paso Natural Gas Company, et al.*, Opinion No. 737 (1975).

In order to accommodate the various applicants involved in these offshore projects, the Commission will tender to the natural gas producers, in the alternative, temporary or permanent certificates. Where the producers accept permanent authorization pursuant to the certificates hereinafter issued, specific conditions will eliminate all controversial issues. This can be accomplished by the filing by each producer of a contract amendment consistent with these requirements.

The alternative tendered to each natural gas producer is a temporary certificate which sets the application of the independent producer for hearing and decision and permits gas sales to commence as the Commission has previously permitted in the *Getty Oil Company, et al.*, Docket No. CI75-319, *et al.* Each natural gas producer therefore has the option of accepting a temporary certificate to commence operations and proceed to formal hearing on the issues raised by its contract for the sale of gas, or in the alternative accept a permanent certificate as conditioned and conclude action on its application.

[7]

By subsequent notice, the Secretary of the Commission will designate the applicants and Docket Nos. which will be the subject of the hereinafter scheduled hearing. Natural gas producers which accept neither permanent nor temporary authorization pursuant to this order will have their application set for hearing as part of the consolidated proceeding.

Petitions to intervene have been filed by United Gas Pipeline, Natural, Consumers Power Company, Mississippi River Transmission, Southern, and Columbia in Docket No. CP75-329.

At a hearing held on , 1976, the Commission on its own motion received and made a part of the record in these dockets all evidence, including the applications, as supplemented and amended, and exhibits thereto, submitted in support of the authorizations sought herein, and upon consideration of the record.

The Commission finds:

(1) Each Applicant will be or is a "natural-gas company" within the meaning of the Natural Gas Act as heretofore found by the Commission.

(2) The sale of natural gas hereinbefore described, as more fully described in the application will be made in interstate commerce subject to the jurisdiction of the Commission; and such sale by Applicant, together with the construction and operation of any facilities subject to the jurisdiction of the Commission necessary therefor, are subject to the requirements of Subsections (c) and (e) of Section 7 of the Natural Gas Act.

(3) It is necessary and appropriate in carrying out the provisions of the Natural Gas Act that the FPC gas rate schedule related to the authorizations hereinafter granted should be accepted for filing.

(4) The sales of natural gas hereinbefore described and as more fully described in the applications of natural gas producers in these dockets will be made in interstate commerce subject to the jurisdiction of the Commission, and such sales by said persons, together with the construction and operation of any facilities subject to the

jurisdiction of the Commission necessary, therefore, are subject to the requirements of subsection (c) and (e) of Section 7 of the Natural Gas Act.

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The Commission orders:

(A) Permanent certificates of public convenience and necessity are issued upon the terms and conditions of this order authorizing the sale by natural gas producer applicants herein of natural gas in interstate commerce for resale for ultimate public consumption, together with the construction and operation of any facilities subject to the jurisdiction of the Commission necessary therefor, subject to Opinion No. 699, as amended, and any further orders issued thereunder, conditioned to the lesser of the contract rate or the national base rate of 52.0 cents per Mcf (14.73 psia), subject to upward and downward Btu adjustment from a base of 1,000 Btu per cubic foot, plus a 0.5 cents per Mcf gathering allowance, all as hereinafter described and as more fully described in the applicants in said dockets, subject to the following conditions.

(B) All petitioners to intervene are permitted to intervene in all the proceedings in which they have filed petitions to intervene subject to the rules and regulations of the Commission; *provided, however,* that participation by such interveners shall be limited to matters affecting asserted rights and interests as specifically set forth in the petitions to intervene; and, *provided, further,* that the admission of such interveners shall not be construed as recognition by the Commission that they might be aggrieved, because of any order of the Commission entered in these proceedings.

(C) The certificates issued in paragraph (A) and (H) shall be void and without force or effect unless accepted in writing by Applicants within 30 days from the issue date of the order issuing such certificates; *Provided, however,* that if an application for rehearing of such order is filed in accordance with Section 19 of the Natural Gas Act, such acceptance shall be filed within 30 days from the issue date of the order of the Commission upon the application for rehearing or within 30 days from the date on which such application may be deemed to have been denied when the Commission has not acted on such application within 30 days after it has been filed; *Provided, further,* that if a petition for review is filed in accordance with the provisions of Section 19 of the Natural Gas Act, such acceptance shall be filed within 30 days after final disposition of the judicial review proceeding thus initiated.

(D) The certificates issued in paragraph (A) and (H) and the rights granted thereunder are not transferable and shall be effective only so long as Applicants continue the acts or operations hereby authorized in accordance with the provisions of the Natural Gas Act and the requirements, rules, and regulations of the Commission.

(E) The grant of the certificates issued in paragraph (A) and (H) shall not be construed as a waiver of the requirements of Section 4 of the Natural Gas Act or Part 154 or Part 157 of the Commission's Regulations thereunder and is without prejudice to any findings or orders which have been

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or which may hereafter be made by the Commission in any proceeding now pending or hereafter instituted by or against Applicants. Further, our action in this proceeding shall not foreclose or prejudice any future proceedings relating to the operation of any price or related provisions in the gas purchase contracts herein involved. The grant of the certificates herein for service to the particular customers involved shall not imply approval of the terms of the contracts, particularly as to the cessation of service; termination must be pursuant to Section 7(b) of the Natural Gas Act. The grant of the certificates herein shall not be construed to preclude the imposition of any sanctions pursuant to provisions of the Natural Gas Act for the unauthorized commencement of any sale of natural gas subject to said certificates.

(F) Applicants, upon acceptance of a permanent certificate in paragraph (A) above shall within 30 days of said acceptance file with the Commission an amendment to its gas sale contract to delete any reservation of gas for its own use and to dedicate all of the commercially producible gas reserves from the surface to the limit of the well bore.

(G) Section 154.93 of the Regulations under the Natural Gas Act is hereby waived to permit the inclusion in Applicants rate schedules of the contractual provision for rate increases to a higher area rate found to be proper by hearing, rulemaking or a Commission approved settlement and the reimbursement by buyer of any excess royalty payments. Any rate increase based on the excess royalty provision is subject to rejection.

(H) Based upon the allegations presented upon the need for additional natural gas supplies, the Commission finds that an emergency exists and temporary certificates are hereby issued to natural gas producer Applicants herein pursuant to Section 7 of the Natural Gas Act authorizing the sale by Applicants in these dockets of natural gas in interstate commerce for resale for ultimate public consumption, together with the construction and operation of any facilities subject to the jurisdiction of the Commission necessary therefore, subject to Opinion No. 699, as amended, and any further orders issued thereunder, conditioned to the lesser of the contract rate or the national base rate of 52.0¢ per Mcf (14.73 psia) subject to upward and downward Btu

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adjustment from a base of 1,000 Btu per cubic foot, plus a 0.5 cent per Mcf gathering allowance, subject to conditions stated above and hereafter.

(I) Applicants acceptance or rejection of the temporary certificates shall be filed within 30 days of the date hereof. If accepted, the temporary certificate shall be effective upon the date of receipt of the acceptance by the Secretary. Service under the temporary certificate shall commence within 30 days from the date of completion of the facilities by the purchaser or transporter. Such service shall be continued unless or until abandonment authorization is granted pursuant to Section 7(b) of the Natural Gas Act whether the contract term has expired or not. The issuance of temporary certificate and the acceptance of the rate schedule are without prejudice

to such final disposition of the application for certificate as the record may require.

(J) The applications in Docket Nos. CI76-190, CI76-192, CI76-193, CI76-225, CI76-244, CI76-317, CI76-318, CI76-357 and CP75-329 are hereby consolidated for hearing and decision with CP76-14, *et al.* By subsequent notice, the Secretary of the Commission will delete herefrom each application which is concluded by acceptance of a permanent certificate issued by paragraph (A) above.

(K) *On or before February 26, 1976,* Applicants and all persons in support shall each file their prepared testimony and exhibits comprising their case-in-chief, and in compliance with paragraph (N) below upon all parties to the proceeding, the Office of the Administrative Law Judges, the Commission Staff and all parties to the consolidated proceeding.

(L) A Presiding Administrative Law Judge to be designated by the Chief Administrative Law Judge for that purpose (See Delegation of Authority, 18 CFR 3.5(d)) shall preside at the hearing in this proceeding, with authority to establish and change all procedural dates, and to rule on all motions (with the sole exception of petitions to intervene, motions to consolidate and sever, and motions to dismiss, as provided for in the Rules of Practice and Procedure).

(M) Pursuant to the authority of the Natural Gas Act particularly Sections 7, 14, 15, 16 thereof, the Commission's Rules of Practice and Procedure, and the Regulations under

the Natural Gas Act (18 CFR Chapter 1), a public hearing shall be held commencing March 23, 1976, at 10:00 a.m. (EST) in a hearing room at the Federal Power Commission, 825 North Capitol Street, N.E., Washington, D. C. 20426, concerning the matters in these consolidated dockets, at which time, *inter alia,* applicant's witnesses shall be presented in support of prepared evidence as detailed in paragraph (N) below.

(N) Each natural gas producer shall present as part of its prepared evidence in the consolidated hearing supporting data to show: Schedule I, the volumes of natural gas to be produced and sold from each field in which it has an interest during the term of its contract from contractually specified formations; Schedule II, the estimated gross and net recoverable natural gas reserves in each formations in each field; Schedule III, the estimated gross and net recoverable natural gas reserves commercially producible from the surface to the limit of the well bore; and Schedules IV, V and VI, deliverability schedules related to each of the reserve estimates called for above. Each natural gas producer shall also present a schedule of payments received and anticipated to be received from the interstate pipeline company proposing to purchase gas from the field. In order to reduce the volume of evidence submitted, a natural gas producer having an undivided interest in the Field may adopt the evidence of another producer as showing its reserves and deliverability.

(O) The rate schedules and rate schedule supplements related to the authorizations granted herein are accepted for filing to become effective on the date of initial de-

livery. Applicants shall advise the Commission of said date within 10 days thereof.

The rate schedules have been designated as follows:

Description	*Designation*
Contract 9-26-1975	Atlantic Richfield Company R.S. 701
Contract 12-15-1975	Case-Pomeroy Oil Corp. R.S. 7
Contract 12-15-1975	Felmont Oil Corp. R.S. 24

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Description	*Designation*
Contract 8-1-1975	Shell Oil Co. R.S. 407
Contract 1-15-1973	Bethlehem Steel Corp. R.S. 1
Contract 1-15-1973	Florida Gas Exploration Co. R.S. 9
Contract 1-15-1973	Dorchester Exploration Ltd. R.S. 7
Contract 1-15-1973	Mitchell Energy Offshore Corp., *et al.*, R.S. 5

(P) Applicant natural gas company's attention is directed to Commission Order No. 539, issued October 14, 1975, F.R. , and to the provisions of Section 2.83 General Policy and Interpretations, 18 CFR 2.83. Moreover, issuance of this certificate authorization

is conditioned to require Applicant, within 30 days of the initial reserve determination or any subsequent redetermination thereof, to report the results of each such initial or redetermination study to the Commission. The certificated minimum daily delivery obligation of the seller (1) shall be determined in accordance with applicable provisions specifically set forth in seller's contract unless otherwise changed by the certificate authorization; (2) shall be without regard to any contractual reservations contrary to the certificate authorization; (3) and shall remain in full force and effect unless and until changed by appropriate certificate authorization amendment based upon Applicant's full documentation of, *inter alia*, the reasons for any such proposed amendment, the sales production history, the amount of remaining connected reserves of Applicant dedicated under the contract and the status of Applicant's nondeveloped reserves dedicated under the contract. The certificate authorization is further conditioned to require that Applicant, if it has not secured an appropriate certificate amendment and there are circumstances resulting in the delivery of a lesser quantity of natural gas than any certificated delivery obligation, Applicant shall file for each contract year quarter, a verified report setting out the circumstances

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of such lesser deliveries and the corrective actions which Applicant proposes to undertake in order to meet any experienced delivery deficiency, such verified reports to be filed within 10 calendar days after expiration of each contract year quarter.

(Q) Certificates issued by this order to natural gas producers and gas begins to flow under such authority makes the certificates service authority binding on both seller and buyer until such time as the Commission authorizes a change in the certificated service regardless of any contractual provision to the contrary.

(R) Transco, Columbia, Natural and TGP shall file within 45 days after service commences under the certificates issued herein, a verified statement showing *pro forma* Form 15 gas reserves and deliverability schedules for these fields, and representations of reserves controlled which will be made to stockholders, or contained in a prospectus or registration statement in connection with financial reporting.

(S) Acceptance of the rate schedules of Applicants herein pursuant to temporary authorization in paragraph (H) does not constitute Commission approval of the contractual reservations or limitations involved pending resolution of the matter on the merits after hearing and decision. Appropriate authorization from the Commission is required by any pipeline to transport any gas which the producers may be permitted to reserve.

(T) Within 30 days from the date of this order, applicant in Docket No. CI76-225 shall file statement demonstrating the applicability of the rate, terms and conditions of Opinion No. 699-H. If such statement is filed with the Secretary within 30 days, the rate may be made effective as of the date of initial delivery.

(U) Within 30 days from the date of this order, applicants in Docket Nos. CI76-190, CI76-192, and CI76-193 shall file the written waiver required by Section 2.56a(i) of the rules pertaining to contingent escalations and refund credits. If such waiver is filed within 30 days, the rate may be made effective as of the date of initial delivery.

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(V) Within 30 days from the date of the order, each producer applicant shall file three copies of a revised billing statement which clearly reflects the components of the authorized rate, namely, base rate, Btu adjustment and gathering allowance.

(W) The Secretary of the Commission is directed to serve a copy of this order on Shepherd Offshore Ventures, Zapata Corporation, Atlantic Richfield Company and Skelly Oil Company, which shall file a written statement within 15 days of the date of this order advising the Commission of its intentions with regard to its interest in Federal Domain Block 185 Field, South Timbalier Area.

(X) TGP, Trunkline, Natural, Transco and Stingray Pipeline shall file appropriate rate schedules 30 days prior to the initiation of any transportation service for natural gas producers for the transportation of liquids from these Fields, together with a supporting cost-of-service exhibit.

(Y) C&K Petroleum Inc., (Operator), shall file copies of all operating agreements in Block 185 Field so long as certificates are not issued and accepted by Shepherd, Zapata, Richfield and Skelly as applicable to their respective field operations herein.

(Z) Applicants, Bethlehem, FGEC, Dorchester and Mitchell shall file a contract amendment deleting the favored-nations clause from their contracts within 30 days from the date of this order.

By the Commission. Commissioner Watt, concurring, filed a separate statement appended hereto.

(SEAL)

KENNETH F. PLUMB,
Secretary.

[1]

Natural Gas Pipeline Company of America, *et al.*) Docket No. CP76-14 *et al.*

(Issued February 12, 1976)

WATT, Commissioner, *concurring:*

Commissioner Smith, on June 3, 1975, dissented in the Getty Oil Company case, lead Docket No. CI75-319, and on November 21, 1975, in the Natural Gas Pipeline Company of America case, lead Docket No. CP76-14 (the docket number before us.) He properly raised questions about the authorities of the Federal Power Commission to restrict or expand in individual initial sale certification applications the obligations of the producers. I share some of the concerns he voiced.

These matters, however, can best be addressed at such time as formal hearings have been held and the issues presented to the Commission within the context of an evidentiary record.

I am concerned on yet another issue embodied in this Order. On November 28, 1975, the Commission issued an Order granting reconsideration of Order No. 539. There are several policy and legal questions surrounding Order No. 539 that must be addressed by this new Commission. Because of these questions, I have reservations regarding the advisability and thrust of including requirements from Order No. 539, (Sec. 2.83 of the Commission's General Policy and Interpretations) in certificates.

To pursue the specifics of these issues at the present time could cause delays in introducing new sources of natural gas to the interstate market. At a time of shortages and curtailments, we cannot afford this risk. Therefore, I concur in this decision and look forward to the Commission's resolution of these issues.

JAMES G. WATT
Commissioner

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Natural Gas Pipeline Company of America, *et al.*	)	Docket No. CP76-14, *et al.*

NOTICE OF FURTHER EXTENSION OF PROCEDURAL DATES

(February 23, 1976)

On February 17, 18, and 19, 1976, Mid Louisiana Gas Company, Continental Oil Company, Getty Oil Company and Kerr-McGee Corporation respectively filed motions to extend the procedural dates fixed by order issued January 26, 1976, in the above-designated proceeding.

Upon consideration, notice is hereby given that the procedural dates in the above matter are modified for all parties as follows:

Service of Testimony By All Parties	March 25, 1976
Hearing	April 20, 1976

Furthermore, the date by which applicants must accept or reject the temporary certificates, pursuant to ordering paragraphs (c) and (l) of order issued January 26, 1976 in Docket No. CP76-14, *et al.*, is extended to and including March 25, 1976.

KENNETH F. PLUMB
Kenneth F. Plumb
Secretary

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Natural Gas Pipeline Company of America, *et al.*) Docket No. CP76-14, *et al.*

ERRATA NOTICE

(March 10, 1976)

NOTICE OF FURTHER EXTENSION OF PROCEDURAL DATES

(Issued February 23, 1976)

Please change the first paragraph to read as follows:

"On February 17, 18, and 19, 1976, Mid Louisiana Gas Company, Continental Oil Company, Getty Oil Company and Kerr-McGee Corporation, respectively, filed motions to extend the procedural dates fixed by orders issued January 26 and Febraury 12, 1976, in the above-designated proceeding."

KENNETH F. PLUMB
Kenneth F. Plumb
Secretary

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Richard L. Dunham, Chairman, Don S. Smith, John H. Holloman III, and James G. Watt.

Natural Gas Pipeline Company of America, *et al.*) Docket Nos. CP76-14, *et al.*

ORDER GRANTING REHEARING FOR THE LIMITED PURPOSE OF FURTHER CONSIDERATION AND REFERRING MOTIONS FOR STAY

(Issued March 19,1976)

On February 20, 1976, Shell Oil Company (Shell) filed an application for rehearing and reconsideration of the Commission's order of February 12, 1976 in this docket. Additional applications for rehearing and reconsideration of the February 12, 1976 order have been filed on March 8, 1976, by Continental Oil Company (Continental) and on March 15, 1976, by Mitchell Energy Offshore Corporation, *et al.* (Mitchell).

On February 23, 1976, Mobil Oil Corporation (Mobil) filed an application for rehearing and reconsideration of the Commission's order of January 26, 1976 in this docket. Additional applications for rehearing and reconsideration of the January 26, 1976 order have been filed on February 24, 1976, by Continental and on February 25, 1976, by Texaco Inc. (Texaco), the California Company, a Division of Chevron Oil Company (Calco), and Burmah Oil Development, Inc. (Burmah).

Various applicants for rehearing request stay of certain conditions contained in the January 26 and February 20, 1976 orders in this proceeding, objecting to the requirements prescribed by Order No. 539, issued October 14, 1975 in Docket No. RM76-8.

[2]

With respect to the various motions for stay, we will refer those motions relative to the imposition of delivery obligations for consideration with other matters pending on rehearing of Order No. 539 in Docket No. RM76-8.

The Commission orders:

The applications for rehearing and reconsideration filed by Mobil, Continental, Texaco, Calco and Burmah dated February 23, 1976, February 24, 1976 and three applications dated February 25, 1975 respectively, of the January 26, 1976 order in this docket are granted for the limited purpose of further consideration. The applications for rehearing and reconsideration filed by Shell, Continental and Burmah dated February 20, 1976, March 8, 1976 and March 15, 1976, respectively, of the February 12, 1976 order in this docket are granted for the limited purpose of further consideration.

Motions for stay relative to the imposition of delivery obligations are referred for consideration with other matters pending on rehearing of Order No. 539 in Docket No. RM76-8.

By the Commission.

(S E A L)

Kenneth F. Plumb,
Secretary.

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Richard L. Dunham, Chairman; Don S. Smith, John H. Holloman III, and James G. Watt.

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Service Under Certificated Arrangements	)))))	Docket No. RM76-8

ORDER NO. 539-A

ORDER GRANTING IN PART AND DENYING IN PART RECONSIDERATION, CLARIFYING ORDER NO. 539, DENYING STAY, NOTICING OF PROPOSED RULEMAKING, NOTICING OF ORAL ARGUMENT AND GRANTING INTERVENTION

(Issued March 26, 1976)

On October 14, 1975, the Commission issued Order No. 539, which adopted Section 2.83 of the Commission's General Policy And Interpretations, setting forth a statement of policy with respect to the enforcement of obligations inherent in certificates of public convenience and necessity granted by this Commission.

Applications for rehearing and/or reconsideration of Order No. 539 were filed by Phillips Petroleum Company on November 10, 1975; Shell Oil Company, *et at,* on

November 12, 1975; Sohio Petroleum Company, Continental Oil Company, Natural Gas Pipeline Company of America and Napeco, Inc., Tenneco Oil Company, *et at.*, Interstate Natural Gas Association of America, Mobil Oil Corporation, and Texaco, Inc., on November 13, 1975; and by Entex, Inc. on November 14, 1975. The Tenneco, *et at.* group also filed on November 13, 1975 a petition to stay the effectiveness of Order No. 539 "until such time as the issues raised in that Order have been fully considered and resolved." A similar request for a stay was filed by Mobil together with its petition for rehearing and reconsideration.

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By order issued November 28, 1975, the Commission granted reconsideration of Order No. 539 for the purpose of further consideration and stated that all motions for stay would be dealt with at such time as the Commission issued its final order on reconsideration. Subsequently, the State of Louisiana filed notice of intervention in this proceeding, which we herewith grant.

On December 30, 1975, Shell Oil Company, on behalf of itself and 25 other natural gas producers, filed a motion for oral argument of Order No. 539.

In Order No. 539, the Commission reiterated its long standing authority to enforce the obligations inherent in certificate authorizations and contracts for sale. While a contract evinces the private arrangement between a buyer and a seller, it is the certificate issued by the Commission pursuant to Section 7(c) of the Natural Gas Act[1] that

1. 15 U.S.C. §717f(c) (1963).

permits the operation of the contract. Thus, while obligations do arise because of the contract itself, distinct responsibilities are incurred by the recipient of a certificate to perform a particular service in interstate commerce.[2] One aspect of this relationship between private contractual agreement and the certificate of public convenience is a delivery obligation on the part of the producer. This requirement of service was the subject of Order No. 539, in which the Commission restated its intention to require, judicially and administratively, compliance, with the provisions of contracts of sale as embodied in and made legal by the certificates of public convenience and necessity issued by this Commission.

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As the Commission stated in Order No. 539:

> . . . [i]t is the policy of this Commission to enforce all delivery and supply obligations of jurisdictional natural gas producers and jurisdictional natural gas pipelines, as they may be occasioned by applicable regulations of the Commission and the statutory standards of the Natural Gas Act, which govern—and, therefore, which are incorporated within—the certificates for all certificated arrangements authorized pursuant to the Act.

Order No. 539, aside from setting out the Commis-

2. See *e.g.*, *Sunray Midcontinent Oil v. F.P.C.*, 364 U.S. 137, 156 (1960) where the Supreme Court held that once deliveries of natural gas begin in interstate commerce, there can be no cessation of such deliveries without prior Commission approval pursuant to Section 7(b) of the Natural Gas Act. *See also F.P.C. v. John E. Moss, et al.*, ____U.S.____, 44 U.S.L.W. 4278 (March 3, 1976).

sion's policy with respect to certificate enforcement, also promulgated Section 2.83 of the Commission's General Policy and interpretations. This provision, subsection (d) of which is to be included as a condition in all temporary and permanent certificates issued after the effective date of Order No. 539, imposes upon producers certain reporting requirements. Several natural gas companies have objected to the inclusion of Section 2.83(d) in their certificates and have refused to accept proffered certificates.[3]/

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The numerous applications for rehearing and/or reconsideration essentially raise the following issues.

1. Order No. 539 is a substantive rule not a policy statement and is, therefore, procedurally defective for failing to comply with Sections 4 and 5 of the Administrative Procedure Act, 5 U.S.C. 553 (1974).

2. Order No. 539 misinterprets both the contractual arrangements between producers and pipelines

3. *Tenneco Oil Company* in Docket Nos. CI75-719, CI75-746, and CI75-747; *Tenneco Exploration, Ltd.* in Docket Nos. CI75-717 and CI75-748, and *Exxon Corporation* in Docket No. CI74-258. Rehearing of orders issuing certificates have been sought by, among others, *Superior Oil Company* in Docket Nos. CI76-34 and CI76-51, *Transco Exploration Company* in Docket No. CI75-395, *Sun Calvert Company* in Docket No. CI76-233, *Sun Oil Company, et al.* and *Sun Oil Company* in Docket Nos. CI76-189 and CI76-230, *Marathon Oil Company* in Docket Nos. CI76-279 and CI76-195, *Gulf Oil Corporation* in Docket Nos. CI76-224 and CI60-159, *et al.*, by *Shell Oil Company* in Docket No. CI76-225, and by *Phillips Petroleum Company* in Docket No. CI76-68. The Commission will take action in these proceedings upon completion of the rulemaking procedure ordered herein.

and the existing certificated obligations. In this regard, the producers assert that:

(a) there are no *specific* quantitative delivery obligations on the part of producers because producer/pipeline contracts do not contain any provisions which relate to this type of an obligation;

(b) Order No. 539 has turned all contracts into *warranty* type contracts whereby a producer is obligated to deliver a specified daily amount of gas;

(c) any Commission imposition of a warranty obligation would be contrary to the public interest and incorrect as a matter of policy;

(d) the Commission has exerted control of production activities in contravention of Section 1(b) of the Act.

3. The reporting to the Commission under Section 2.83(d) of the initial reserve determination or any subsequent redetermination should be kept confidential.

4. Order No. 539 cannot supercede the right of a producer to reserve, in a contract, gas for its own use.

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It is quite obvious from the arguments raised concerning a producer's obligations and requirements under a certificate of public convenience and necessity that many parties do not understand the intent and purpose of Or-

der No. 539. That Order merely reiterated the Commission's authority (see *e.g.*, Section 7(b) of the Natural Gas Act) to enforce all obligations, including any delivery obligations, that are set out in a contract between a producer and a pipeline and certificated by the Commission. Order No. 539 was promulgated to insure that once deliveries of natural gas commence in interstate commerce under the terms of a contract and certificate, such deliveries continue in accordance with the terms of the contract and certificate, and that prior to termination of such deliveries the requisite abandonment authority is obtained from the Commission. Order No. 539 did not, however, transform a gas sales contract between a producer and a pipeline into a warranty contract guaranteeing delivery of a specific volume of gas irrespective of the source.[4]/

Movants have seized upon the language "certificated minimum daily delivery obligation" contained in Order No. 539 to infer that: (1) the Commission will enforce a daily delivery of *specific* volumes of gas without any deviation or fluctuation irrespective of the delivery terms of the contract; and (2) the take or pay provisions of a contract will be used by the Commission to determine this daily amount. Yet, as stated previously, this was not the Commission's intent in promulgating Order No. 539. Rather, the Commission intended to inform all parties to gas sales contracts that once deliveries under such contracts, as certificated by the Commission, commence in

4. *Tenneco Oil Company and Tenneco Exploration Company, Ltd.*, Order Granting Rehearing For Limited Purpose Of Reconsideration, Clarifying Prior Order and Referring Motions For Stay to Rulemaking Proceeding, Docket Nos. CI75-717, et al. (December 12, 1975).

interstate commerce, such deliveries continue without unjustifiable unilateral interruption in accordance with the applicable provisions of the contract. The Commission did not intend to imply that a take or pay provision in a contract necessarily constituted the delivery obligation. However, if the intent of the parties to the contract was, or if the reasonable reading of the contracts indicate, that the take or pay provision governs the delivery obligation of the producer, then the Commission will enforce, under Order No. 539, that obligation.

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If, however, other provision of the contract govern delivery obligation, the Commission will enforce those provisions. Thus, the Commission recognizes that contracts do differ. Moreover, the Commission recognizes the fact that deliveries of gas will fluctuate sometimes daily, monthly or seasonably because of a variety of factors and the Commission recognizes that these fluctuations are a result of the physical characteristics of the natural gas business. Yet, the fact that the ability to deliver gas may change from time to time due to the nature of hydrocarbon production does not relieve a producer from its obligation to deliver in accordance with the contract and certificate. This is precisely why the Commission included in Section 2.83 a provision whereby an applicant would notify the Commission of a change in the certificated delivery obligation (*i.e.*, a reduction in deliveries inconsistent with the contractual provisions as certificated, or total termination of deliveries) and why the Commission requires the delivery obligation to remain in effect unless and until changed by appropriate certificate authorization amendment.

In response to the specific arguments raised, the Commission would first note that, as stated above, Order No. 539 does not impose a specific warranty obligation if none is provided for in the contract. Second, since Order No. 539 only announces the Commission's intent to enforce contract and certificate obligations, nothing the Commission has done violates the "production and gathering" exemption of Section 1(b) of the Natural Gas Act nor interferes with the jurisdiction of state or federal agencies in that area. Third, since Order No. 539 is merely a restatement of the Commission's long standing authority to enforce certificate obligations, it does not violate any due process rights of petitioners nor does it impose upon them any obligations or duties other than those imposed in their contracts and certificates. Fourth, petitioners assert that Section 2.83(b)(2) which provides that the delivery obligation should be imputed ". . . without regard to any contractual reservations contrary to the certificate authorization . . .", is vague and indefinite. This condition refers to contract provisions relating to the use of gas with respect to lease development and operations, recycling, pressure maintenance or other

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recovery operations, for use by lessors in accordance with lease agreements, or taken in kind by royalty owners. This subsection does not refer to gas reserved to fulfill the commitments of prior contractual agreements or to specific percentage or volume reservations by the seller. Section 2.83(b)(2) indicates that to the extent contract terms vary from that authorized by the certificate, the latter is controlling.

Fifth, petitioners contend that the reserve data required to be submitted pursuant to Section 2.83(d)[5]/ should be kept confidential. First, any information submitted to the FPC pursuant to Section 2.83(d) which contains confidential information may be designated as being confidential by either the party making such filing or any party of interest. Second, pending further order of the Commission, any information which is designated as confidential will be made public only (1) after due notice to all affected parties, or (2) where the information to be made public constitutes composite or aggregate data or data submitted by a party where names and/or other identifying characteristics are deleted.[6]/ Third, the question of whether the information required to be submitted pursuant to Section 2.83(d) should be kept confidential should be addressed by the parties to this proceding at the oral argument to be hereinafter ordered.

Finally, petitioners' arguments that Order No. 539 is a substantive rule rather than a policy statement are, in our view, initially without merit and finally, to be rendered moot by the procedure set out herein. The principal difference between a statement of policy and a substantive rule is that

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the former involves a regulation of general applicability

5. Section 2.83(d) states in part as follows:
. . . issuance of this certificate authorization is conditioned to require Applicant, within 30 days of the initial reserve determination or any subsequent redetermination thereof, to report the results of each such initial or redetermination study to the Commission . . .

6. See *Continental Oil Company v. F.P.C.*, 519 F.2d 31 (5th Cir. 1975).

that is not a final determination of any right or obligation,[7]/ while the latter ". . . establishes a standard of conduct which has the force of law".[8]/ Order No. 539, and the regulation promulgated therein, do not, of themselves, affect the rights or obligations of any certificate holder or applicant. The order is a reiteration of the Commission's policy with respect to the enforcement of certificated contract obligations and an announcement of how it intends to proceed to enforce them. Similarly, Section 2.83 of the Regulations operates prospectively; specifically, the language in Section 2.83(d) will be included in all certificates issued after the effective date of Order No. 539.

Despite petitioners' protestations, this form of action by the Commission, a policy statement enacting new sections of the regulations, is permissible and a commonly used regulatory procedure. For example, in Order No. 296[9] the Commission set out its policy requiring that language be inserted in all future permanent certificates that the price to be paid could not exceed a ceiling prescribed in a previous policy statement. The Commission also provided that if an applicant objected in writing to such a condition, the matter would be set for formal hearing.[10]

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7. *Magnolia Petroleum Co. v. F.P.C.*, 236 F.2d 785, 791 (5th Cir. 1956), *cert. denied*, 352 U.S. 968 (1957). See also, *Memphis Light, Gas and Water Division v. F.P.C.*, 462 F.2d 853 (D.C. Cir. 1972), *rev'd other grounds*, 411 U.S. 458 (1973).

8. *Pacific Gas and Electric Co. v. F.P.C.*, 506 F.2d at 38 (D.C. Cir. 1974). See *Texaco, Inc. v. F.P.C.*, 412 F.2d 740 (3rd Cir. 1969).

9. See *Tenth Amendment To Statement Of General Policy No. 61-1*, Order No. 296, Docket No. R-273, 33 FPC 682 (April 5, 1965).

10. See *Eleventh Amendment To Statement Of General Policy No. 61-1*, Order No. 352, Docket No. R-329, 37 FPC 1204 (June 30, 1967).

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After deliberation, we find that a similar provision should be included in Section 2.83(d). Accordingly, Section 2.83(d) of the Commission's general Policy and Interpretations will be amended to include, at the end of the subsection as set forth in Order No. 539, the following language:

> [t]he foregoing language will be inserted in any temporary or permanent certificate issued after the effective date of Order No. 539, unless at the time of filing such certificate application, or within the time fixed in the notice of application for filing protests or petitions to intervene, the applicant indicates in writing that it is unwilling to accept such a condition, in which event the application will be set for formal hearing to determine, *inter alia*, whether any certificate shall be so conditioned.

Whether such a condition will be applied is to be decided on the basis of the record developed at such hearings. Furthermore, if the Commission determines, after hearings, to so condition the certificate, over the objections of an applicant, the applicant can avail itself of Section 157.20(a) of the Commission's Regulations which provides as follows:

> (a) The certificate shall be void and without force or effect unless accepted in writing by applicant within 30 days from the issue date of the order issuing such certificate: *Provided, however,* That when an application for rehearing of such order is filed in

accordance with Section 19 of the Natural Gas Act, such acceptance shall be filed within 30 days from the issue date of the order of the Commission upon the application for rehearing or within 30 days from the date on which such application may be demed to have been denied when the Commission has not acted on such application within 30 days after it has been filed: *Provided, further,* That

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when a petition for review is filed in accordance with the provisions of Section 19 of the Natural Gas Act, such acceptance shall be filed within 30 days after final disposition of the judicial review proceedings thus initiated.

Finally, in each individual proceeding, the Commission will entertain motions for a partial waiver of Section 157.20 whereby an applicant who is willing to immediately accept a certificate of public convenience and necessity and begin operations under such certificate may do so with the express right to petition the Commission for rehearing and seek judicial review of any Order No. 539 conditions included in the certificate. If after rehearing and/or judicial review, modification or elimination of the conditions imposed becomes necessary the Commission will, of course, act appropriately.

Because it is a reiteration of extant Commission policy that does not finally determine the rights or obligations of any party, Order No. 539, as amended herein, is a statement of policy and as such it is exempt from the notice and hearing requirements of Section 553 of the APA. Therefore, as we stated in our November 28, 1975

order in this docket, rehearing does not lie for a statement of policy. Accordingly, all petitions for rehearing filed herein must be rejected. We shall treat such petitions as applications for reconsideration, and as such, shall grant in part and deny in part reconsideration of Order No. 539 for the reasons previously set forth.

This order should resolve the difficulties envisioned by the parties responding to the promulgation of Order No. 539. However, those responses make resolution of those questions appear highly unlikely. The parties imply in their responses that gas sales contracts do not contain any deliverability obligations whatsoever. As long as there exists uncertainty over the obligations a party incurs by acceptance of a certificate of public convenience and necessarily, the public interest is not served, and the Commission should resolve as many ambiguities as possible. Accordingly, the Commission hereby gives notice pursuant to the APA and the Natural Gas Act, Sections 8, 10, 14, 15, and 16 (52 Stat. 825, 826, 828, 829, 830; 15 U.S.C. 717g, 717i, 717m, 717n, 717o) that it proposes to amend its General Policy and Interpretations by adding a new section regarding the obligations of parties accepting a certificate of public convenience and necessity from this Commission.

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The purpose of this proposed notice of rulemaking is not necessarily to implement through a rule the policy expressed by the Commission in Order No. 539. Rather, its purpose is to examine, through the submission of comments and oral argument, a variety of issues of prime importance regarding certificate obligations in order to determine if a new section is necessary. These issues include the following:

1. Whether the daily contract quantity provision or take or pay provision found in many contracts are considered by the parties to the contract to constitute a delivery obligation?

2. If a contract does not contain a daily contract quantity provision or a take or pay provision, what other provision, if any, governs delivery?

3. Do any of these provisions provide for a specific volume of deliveries over a set period of time?

4. If a contract contains no delivery obligation, should the Commission require one?

5. What is the feasibility of using a uniform contract form for the dedication and delivery provisions?

6. Do the reporting requirements of Subsection 2.83(d) represent the best method of providing the Commission with the data necessary to enforce the policy stated in Order No. 539?

7. Should the information required to be submitted pursuant to Section 2.83(d) be kept confidential?

8. The extent to which other Federal or state agencies have jurisdiction and exercise oversight of production in a manner capable of attaining the objectives sought by the Commission.

This notice of proposed rulemaking is not to be regarded as a rescinding of the Commission policy expressed in Order No. 539, nor is it to be taken as a staying of the effectiveness of the requirement that Section 2.83(d), as amended herein, be included as a condition in all temporary and permanent certificates issued after the effective date of Order No. 539.

Comments on the issues referenced herein and any other issues considered relevant by the parties, including any issues with respect to the policy expressed in Order No. 539, will be filed on or before April 19, 1976. On or before that day, any party may notify the Secretary of its intention to appear and participate at oral argument and the amount of time desired to present its argument.[11] Subsequently, the Secretary will publish a notice stating the order of argument and the time allotted each participant. Oral argument will commence before the Commission on

The Commission orders:

(A) The State of Louisiana is permitted to intervene in this proceeding subject to the Rules and Regulations of the Commission; *Provided, however,* that the participation of such intervenor shall be limited to matters affecting asserted rights and interests as specifically set forth in its notice of intervention; and *Provided, further,* that the admission of such intervenor shall not be construed as recognition by the Commission that the party might be aggrieved because of any order or orders of the Commission entered in these proceedings, and that the intervenor agrees to accept the record as it now stands.

(B) Section 2.83(d) of the Commission's General Policy and Interpretations, as promulgated in Order No. 539, is hereby amended to read as follows:

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11. Since we are holding oral argument on the proposed rulemaking and the policy expressed in Order No. 539, the motion for oral argument filed by Shell on behalf of itself and 25 other gas producers will be granted.

(d) The Commission shall include, subsequent to the date of Order No. 539, the following general language within the Commission's Order Issuing Such Temporary or Permanent Certificate:

> Applicant natural gas company's attention is directed to Commission Order No. 539 issued October 14, 1975, 40 F.R. 49571, and to the provisions of Section 2.83

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> General Policy and Interpretations, 18 C.F.R. 2.83. Moreover, issuance of this certificate authorization is conditioned to require Applicant, within 30 days of the initial reserve determination or any subsequent redetermination thereof, to report the results of each such initial or redetermination study to the Commission. An original reserve estimate or any redetermination thereof, submitted pursuant to Section 2.83(d) will be maintained by the Commission on a confidential basis and will be made public only after due notice to all interested parties. The certificated minimum daily delivery obligation of the seller (1) shall be determined in accordance with applicable provisions specifically set forth in seller's contract unless otherwise changed by the certificate authorization, (2) shall be without regard to any contractual reservations contrary to the certificate authorization, and (3) shall remain in full force and effect unless and until changed by appropriate certificate authorization amendment based upon Applicant's full documentation of, *inter alia*, the reasons for any such

> proposed amendment, the sales production history, the amount of remaining connected reserves of Applicant dedicated under the contract and the status of Applicant's nondeveloped reserves dedicated under the contract. The certificate authorization is further conditioned to require that Applicant, if it has not secured an appropriate certificate amendment and there are circumstances resulting in the delivery of a lesser quantity of natural gas than any certificated delivery obligation, Applicant shall file for each contract year quarter, a verified report setting out the circumstances of such lesser deliveries and

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> the corrective actions which Applicant proposes to undertake in order to meet any experienced delivery deficiency, such verified reports to be filed within 10 calendar days after expiration of each contract year quarter.
>
> The foregoing language will be inserted in any temporary or permanent certificate issued after the effective date of Order No. 539, unless at the time of filing such certificate application, or within the time fixed in the notice of application for filing protests or petitions to intervene, the applicant indicates in writing that it is unwilling to accept such a condition, in which event the application will be set for formal hearing to determine, *inter alia*, whether any grant of certificate shall be so conditioned.

(C) Notice is hereby given of the intention of the Commission to promulgate a new Section 2.83, as amended, of its General Policy and Interpretations, pursuant to a rulemaking procedure.

Any interested person may submit to the Federal Power Commission, 825 North Capitol Street, N.E., Washington, D.C., 20426, not later than April 19, 1976, data, views, and comments or suggestions in writing concerning the proposed rulemaking. Written submittals will be placed in the Commission's public files and be available for public inspection at the Commission's Office of Public Information, 825 North Capitol Street, N.E., Washington, D.C., 20426, during regular business hours. The Commission will consider all such written submittals before acting on the matters herein proposed. An original and 14 conformed copies should be filed with the Secretary of the Commission. Submissions to the Commission should indicate the name, title, and mailing address of the person to whom correspondence with regard to the proposal should be addressed.

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(D) The motion of Shell for oral argument upon the issues raised by the Commission's policy statement expressed in Order No. 539 is granted. On or before April 19, 1976, any party may notify the Secretary of its intention to appear for oral argument and the amount of time desired to present its argument. Subsequently, the Secretary will publish a notice stating the order of argument as to those issues, plus the questions raised with respect to the notice of proposed rulemaking to promulgate Section 2.83 of the Commission's General Policy and

Interpretations will commence before the Commission on May 4, 1976, at 9:00 a.m., E.D.T., in a Hearing Room of the Federal Power Commission at 825 N. Capitol Street, N.E., Washington, D.C., 20426.

(E) The petitions for rehearing, reconsideration, and modification of Order No. 539 are hereby denied, except as otherwise provided for in this order.

(F) The requests for a stay of the effectiveness of Order No. 539 are hereby denied.

By the Commission. Commissioner Watt, dissenting, filed a separate statement appended hereto.

(SEAL)

KENNETH F. PLUMB,
Secretary.

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Policy With Respect To Enforcement of Deliverability And Rendition of Natural Gas Service Under Certificated Arrangements	))))	Docket No. RM76-8

WATT, Commissioner, *dissenting:*

In October of 1975, the Commission issued Order No. 539 composed of two basic parts: a policy statement and new regulations. The policy statement raised serious legal questions about the new thrust and direction of the Commission. The new regulations were adopted without due process of law.

Today's "clarification" of Order No. 539 sets up a different frame of reference for the policy statement. My concerns have been substantially alleviated.

Today's Order announces oral arguments and proposed rulemaking on the new regulations. (Sec. 2.83 of the Commission's General Policy and Interpretations.) Any new requirements such as these should be noticed for rulemaking.

The fact that rulemaking has been set for the adoption of rules and regulations already imposed upon of producers substantiates my earlier belief that those regulations were illegally adopted and are illegally being required as a condition to temporary and permanent producer certificates.

The error of today's Order is in not staying the illegally promulgated regulations. I reserve judgment on the wis-

dom of adopting these regulations until after we have proceeded under the due process of law in evaluating their worth, fairness and legal standing.

/s/ JAMES G. WATT
James G. Watt
Commissioner

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IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

SHELL OIL COMPANY,	)	
Petitioner, *et al.*	)	Case No.
v.	)	76-3066
FEDERAL POWER COMMISSION,	)	
Respondent.	)	

MOTION OF CONSUMER FEDERATION
OF AMERICA FOR LEAVE TO INTERVENE

Consumer Federation of America, pursuant to Rule 15(d) of the Federal Rules of Appellate Procedure, respectfully moves this Court for leave to intervene in the captioned proceedings for review of FEDERAL POWER COMMISSION Order No. 539, issued on October 14, 1975, in Docket No. RM-76-8; Order No. 539-A, issued March 26, 1976, in Docket No. RM76-8; and Order No. 539-B, issued July 30, 1976, in Docket No. RM76-8. In support of its motion, Consumer Federation of America alleges as follows:

I.

Consumer Federation of America is a coalition of over 200 national, state, and local consumer and consumer

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oriented organizations, with a total membership of over

30,000,000 persons. Through its Energy Policy Task Force, the Federation has had a deep and long-standing interest in energy policy issues, including those relating to the delivery of natural gas. In pursuit of this interest, the Federation has testified before various Congressional committees on natural gas issues and has participated or intervened in numerous proceedings before the Federal Power Commission and in State and Federal courts around the country.

II.

The Consumer Federation of America moved to intervene in F.P.C. Docket No. RM76-8 and presented both written comments and oral testimony before the Commission. The Federation, its affiliated organizations and their individual members, have a substantial interest in the level of delivery of natural gas in interstate commerce, since that level of delivery directly affects the cost and availability of such gas to consumers. Thus, the Federation and its members may be seriously and adversely

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affected by the outcome of this litigation. The Federation's views of producers' obligations to deliver natural gas and the Commission's responsibility for enforcing these obligations differ considerably from the views of both the Commission itself and the other parties to this litigation. Therefore, the interests of the Federation and its members will not be adequately represented by any other party to the suit.

WHEREFORE, the Consumer Federation of America respectfully requests that it be granted leave to intervene in this case.

Respectfully submitted,

Consumer Federation of America

By: CHARLES E. HILL
Charles E. Hill
Institute for Public Interest Representation
600 New Jersey Avenue, N.W.
Washington, D.C. 2001
624-8390

Attorney for Petitioner

* * *

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Service Under Certificated Arrangements	))))	Docket No. RM76-8

COMMENTS OF J. S. ABERCROMBIE, C & K PETROLEUM COMPANY, INC., COQUINA OIL CORPORATION, COTTON PETROLEUM COMPANY, TIPPERARY CORPORATION AND TEXASGULF INC.

GORDON GOOCH
BRUCE F. KIELY
BAKER & BOTTS
1701 Pennsylvania Ave., N.W.
Washington, D.C. 20006

Washington, D.C.
April 19, 1976

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Service Under Certificated Arrangements	))))	Docket No. RM76-8

COMMENTS OF J.S. ABERCROMBIE, C & K PETROLEUM COMPANY, INC., COQUINA OIL CORPORATION, COTTON PETROLEUM COMPANY TIPPERARY CORPORATION AND TEXASGULF INC.

Pursuant to Ordering Paragraph (C) of Order No. 539-A issued March 26, 1965, J. S. Abercrombie, C & K Petroleum Company, Inc., Coquina Oil Corporation, Cotton Petroleum Company, Tipperary Corporation and Texasgulf Inc. (hereafter designated "Small Producers") hereby submit their comments concerning the questions and issues raised by Order Nos. 539 and 539-A.

I.

Correspondence with regard to this proceeding should be addressed to:

Bruce F. Kiely
Baker & Botts
1701 Pennsylvania Ave., N.W.
Washington, D.C. 20006

II.

Summary of the Small Producers' Position

These small producers are staggered by the many questions, uncertainties and ambiguities raised by the Commission's issuance, without hearing or opportunity for public comment, of Order Nos. 539 and 539-A. Despite the multitude of issues, we believe three fundamental threshhold questions are presented; two apply to all producers and one issue is special and unique to small producers.

One issue is the nature of a producer's delivery obligation under a standard gas sales contract. In our view, the answer is that although the precise terms of a contract may vary, the delivery obligation remains the same.

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That obligation, in general terms, is that the producer is to deliver the amount of gas that is produced from the acreage covered by the contract as a result of the operating decisions made by the producer in its sole discretion as a reasonably prudent operator. Normally this obligation is subject to the producer's prior right to use gas for certain leasehold operations and certain specified uses by the lessor.

The second issue is whether the Commission (a) can and (b) should impose some delivery obligation on producers other than the obligations set forth in their contracts. These small producers do not believe that the Natural Gas Act gives the Commission authority to impose on producers any delivery obligation other than that set forth in a particular gas sales contract. Even assuming, *arguendo*, that the Commission has the authority to impose a non-contractual delivery obligation, these small producers submit that the exercise of such bare legal authority is not in the public interest to producers in general and small producers in particular.

The third basic issue in this proceeding is whether the Order No. 539-A condition and procedures apply to the

small producers and, if so, how? These small producers submit that Order No. 539-A should not apply to small producers because, pursuant to Order No. 428 and 18 CFR 157.40, small producers, once issued a small producer certificate, do not have to file applications under Section 7(c) for each sale of gas in interstate commerce. Therefore, the procedures set forth in Order No. 539-A do not take into account the small producer situation.

A final question as to small producers is which small producer certificates or sales, if any, are subject to Order No. 539-A. These indicated small producers firmly believe that Order No. 539-A should be rescinded as to all producers and particularly as to small producers; however, if it remains effective, it should be made prospective only so that small producers have notice of what burdens, administrative and economic, they will face if they sell gas in interstate commerce.

III.

The Producers' Contractural Obligation

Review of the standard producer gas sales contract will reveal that the purchaser of the gas is obligated to take or pay for a certain quantity of gas produced from the acreage dedicated to the contract. In turn, the producer

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undertakes a delivery obligation. It is significant to note that in the typical producer contract, the producer's delivery obligation is separate and distinct from the purchaser's take-or-pay obligation.

Regardless of whether the purchaser's take-or-pay obligation is expressed in terms of a specified percentage of the delivery capacity of the wells or as a percentage or ratio of recoverable reserves, the producer's delivery obligation does not change. *That obligation is to deliver all of the gas produced from the acreage dedicated to the contract,* except for gas reserved for leasehold operations.

Even in contracts where the producer is to deliver at

the delivery capacity of a well at the Maximum Efficient Rate (MER) or the state allowable rate the obligation is to sell the delivery capacity as established by testing, *or, if the amount delivered on a particular day is less than the delivery capacity, the delivery capacity is reduced.* In other words, the delivery obligation always is tied to production.

Similarly, where the delivery obligation is based on a percentage of recoverable reserves, the amount to be delivered equates to the amount that can be produced from the wells. Again, the obligation is related to production.

It is clear that the amount of deliverability that a producer can develop and sustain from wells on leases covered by a contract is a function of the decisions the producer makes in the process of operating the wells on the dedicated acreage. These operating decisions are for the producer alone to make as a reasonable prudent operator. No other party to the contract can control those decisions.

Despite the fact that under the typical producer contract the delivery obligation is determined by the amount of gas produced, the Commission in Order Nos. 539 and 539-A appears to be equating the *producer's* delivery obligation with the *purchaser's* take-or-pay obligation. These small producers believe that such a view is contrary to the typical producer contract. That view also leads to the paradoxical result that if the delivery obligation is to be considered equal to the take-or-pay obligation the producer's delivery obligation would be *less* than provided in the contract. To test this conclusion all that is necessary is to compare the take-or-pay provisions and delivery obligations in the typical contract and find that the take-or-pay is only a fraction of the delivery obligation.[1]

[1] The purpose, of course, of the take-or-pay, was to compensate a producer for having gas available for delivery, and, to provide the producer a minimum source of cash flow during periods when the pipeline, for some reason, elects not to take the entire production under a contract.

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A Delivery Obligation Other Than That In A Producer's Contract Is Beyond The Scope of The Natural Gas Act

The Commission should make it absolutely clear that Section 2.83(d) does not impose a delivery obligation except that set forth in producer contracts because:

A. *The Commission Has No Jurisdiction To Prescribe A Delivery Obligation Other Than That In The Producer's Contract*

Section 1(b) of the Natural Gas Act makes clear that the Act "shall not apply to . . . the production . . . of natural gas." "Production" has been judicially construed to encompass "the physical activities, processes, and facilities of production . . . ." *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392, 402 (1965).

The general conditioning authority under Sections 7(c) and 7(e) does not override the exemption of "production" from Commission jurisdiction. Those conditioning provisions only can be used to carry out other substantive provisions of the Act. Since Section 1(b) specifically excludes "production" from Commission jurisdiction, Sections 7(c) and 7(e) cannot override that exemption. The Courts have not hesitated to restrain Commission enthusiasm to, *sua sponte*, expand the authority given it under the Act. In *Panhandle Eastern Pipe Line Co.* v. *FPC*, 337 U.S. 498 (1949) involving an attempt by the Commission to rely on its general power to regulate interstate transportation and sales for resale to expand its § 7(c) powers; the Supreme Court prophetically noted: "Would it soon be required that the statutory power to require extension of service—§ 7(a)—included power to require exploration or acquisition of leases or allocation of production to interstate pipelines in order to serve the public interest?" 337 U.S. at 508. The result in that case: The Supreme Court found "The power to do things appropriate to carry out the provisions of the Act can hardly be taken to rescind a prohibition against certain

actions." That principle applies equally well in the instant case. The Act gives the Commission no authority to order a producer to make decisions relating to production activities and the general provisions of the Act cannot be used to provide such authority.[2]

Decisions as to production involve matters of corporate judgment as to whether to invest more capital for such matters as enlarging facilities, reworking or redrilling

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wells or adding compression. The Courts have held that the decision to invest capital is to be left to the corporation. *See Panhandle Eastern Pipe Line Co.*, 204 F.2d 675, 680 (3rd Cir. 1953); *Central West Utility Company* v. *FPC, supra; Panhandle Eastern Pipe Line Co. et al.*, 15 FPC 46, 50 (1956). In Opinion No. 546, Area Rate Proceeding (Southern Louisiana Area), 40 FPC 530, 617 (1968), the Commission at length addressed the question of the limits on its authority to direct producers to spend money on exploration or production:

> The independent gas producer may curtail or cease its exploration and development activity at any time.[59] This may be done without approval or permission from any regulatory body. A producer is required to continue to furnish gas from supplies already dedicated to interstate commerce, but he is not compelled to make further investment, to seek further supplies or to dedicate other supplies he may have to interstate commerce. A producer determines the amount it wishes to spend on exploration and development and such expenditures are not, and probably cannot be, subject to the scrutiny of a regu-

[59] The ordinary public utility does not have corresponding costs which it may curtail at will.

[2] *Cf.* Central West Utility Co. v. FPC, 247 F.2d 306 (10th Cir. 1957); Panhandle Eastern Pipe Line Co. v. FPC, 204 F.2d 675 (3rd Cir. 1953).

latory body to determine whether the investment was prudent. . . If exploration and development activities do not yield sufficient results they may be discontinued at the producer's option. If a producer wishes to assume the business risk that these operations will be profitable at the price allowed by this Commission, this is his decision. 40 FPC at 617.

The Section 1(b) exemption was not inadvertent but rather was designed to leave to the states the power to regulate production activities on non-federal lands. *FPC* v. *Panhandle Eastern Pipe Line Co., supra.* As to federal lands, onshore production is governed by the Federal Mineral Leasing Act, 30 U.S.C. §§ 181, *et seq.* and offshore is regulated by the Department of Interior.[3]

For these reasons, it is clear the Commission has no authority to impose a delivery obligation other than contained in a producer's contract.

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B. *The Public Interest Is Not Served.*

Even if the Commission were to have the bare legal authority to impose a delivery obligation condition other than that in a producer's contract, these small producers submit that such a condition is not in the public interest. We hope that the issuance of Order No. 539-A in fact means that the Commission does not intend to impose a delivery warranty condition.

Perhaps forgotten in the issuance of Order Nos. 539 and 539-A is the fact that if those orders apply to small producers the administrative burden will be immense. By a recent count, there are over 6,000 small producers holding small producer certificates.[4] If it is assumed that those producers have only five contracts for the sale of gas in interstate commerce, the filing requirements under Section 2.83(d) would total more than 30,000 filings.

[3] Outer Continental Shelf Lands Act, 43 U.S.C. § 1341-3.

[4] Source FPC Form Nos. 300 and 301.

It was to avoid such an administrative morass that the small producer exemption was adopted in Order No. 428. As the Supreme Court noted in approving indirect regulation of small producers,[5] one of the primary goals and functions of the small producer certificate is that "when he enters into a new contract for the interstate sale of gas, *the provisions of his contract will not be changed.*" (Emphasis supplied). Order No. 428, 45 FPC 454, 455 (1971). In our view Order Nos. 539 and 539-A in large part defeat the goals of the small producer exemption.

The orders also unfairly and improperly impose on small producers conditions which did not exist when they initiated sales in interstate commerce. These small producers submit that such surprise *ex post facto* orders by the Commission serve to discourage the entrance of new producers into the interstate market and drive producers already making jurisdictional sales to make any new sales in the non-Commission regulated market.

We are very concerned, also, by various aspects of Order 539-A and Section 2.83(d). For example,

1. What is meant by the reserve determination?

Apparently this refers to the type of reserve determination *sometimes* used for take-or-pay purposes. Such determinations often, however, are not set forth in contracts. For small producers this presents particular problems. First, small producers as a rule do not have the personnel

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available to prepare and file the necessary documentation *if* such a determination has been made. Even worse is the situation where no such reserve determination has been made. Additional employees or outside consultants will be required just to prepare, monitor and adjust reserve calculations.

As small producers induced by the Commission in Order No. 428 to sell gas in interstate commerce we feel

[5] FPC v. Texaco, Inc., *et al.*, 417 U.S. 380 (1974).

betrayed by the burgeoning reporting requirements imposed on us. It is particularly oppressive when we are ordered to make reserve calculations not even required by our contract.

2. Assuming, *arguendo*, the authority to impose a warranty condition, why the need for all the data required by Section 2.83(d)?

As stated above, small producers are particularly disadvantaged by the massive reporting requirements recently mandated by the Commission. *See* Order Nos. 526 and 543. Section 2.83(d) is particularly onerous because it requires reporting for every contract initially and whenever changes occur. We submit that there simply is no need for the Commission to require the data set forth in Section 2.83(d). Already our operations are regulated by the various states in which we operate and the United States Geological Survey governs our offshore federal operations.[6] The additional reporting requirement of Section 2.83(d) is overly burdensome, unnecessary and contrary to the principles of Order No. 428.

3. What is the effect of Section 2.83(d) on lease operation reservation of gas?

Our review of Section 2.83(d) indicates that it does not make any provision for the lease operations reservation.[7] We trust the Commission does not plan to compel producers to violate its lease obligations and produce the leases without benefit of the gas needed to efficiently operate the leases.

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[6] 43 U.S.C. § 1331, *et seq.*; 30 C.F.R. § 250.1, *et seq.*

[7] This reservation is common to virtually all producer contracts and reflects the purchaser's acknowledgment of the obligation of the producer to its lessors and the need of the producer to use the gas to promote efficient production.

4. Small producers need no incentive to produce leases at maximum production rates.

The notion that runs throughout Order Nos. 539 and 539-A is that producers are not producing leases dedicated to interstate commerce at a fast enough rate. These small producers take issue with that idea.

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The Commission should realize that most small producers have the best incentive in the world to produce their wells at the maximum safe level. That incentive is the need to recover their, and their investors money, as rapidly as possible. Most small producers have very high equity financing and to meet the requirements of the equity holders and to continue to attract equity holders small producers must produce the wells rapidly to generate the cash flow necessary to meet these equity needs. Most small producers simply do not have large enough operations to absorb the administrative and legal burdens imposed by Commission policies such as Order No. 539-A, and Commission Forms 40, 64 and 108.

All the myriad of reporting forms and provisions like Section 2.83 do is divert our attention, our manpower and resources from the business of finding and producing gas.

V.

Order *No. 539-A and Section 2.83(d) Are Not Designed To Apply to Small Producers*

Order No. 539-A promulgating Section 2.83(d) provides, *inter alia*, that the conditions in that section "be inserted in any temporary or permanent certificate issued after the effective date of Order No. 539."

Even this threshold order does not fit the small producer situation. Simply stated, as set forth in Section 157.40, small producers, once issued a small producer certificate, do not file applications for certificates each

time they enter into a contract and sell gas in interstate commerce. This raises a myriad of questions, the answer to which portends serious issues of due process, unjust discrimination, and lack of adequate notice.

1. Does Section 2.83(d) apply to small producers?
2. If Section 2.83(d) does apply to small producers, how does it apply?

As the Commission is aware, once a small producer receives a "small producer certificate", it no longer has to file for a Section 7(c) certificate for each sale of gas in interstate commerce. Many small producers already have their certificates and are concerned whether the Commission now is, in *ex post facto* fashion, imposing Section 2.83(d) on each of those certificates.

If it is the Commission's intent to have Section 2.83(d) apply without prior notice to small producer certificates previously issued or sales already commenced, it is our view that this would be a gross violation of due process.

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3. Assuming, *arguendo*, that Section 2.83(d) is imposed, how is it imposed?

Because of the nature of small producer certificates, the certificate covers each individual sale of gas in interstate commerce until annual production exceeds 10 Bcf. Does Order No. 539-A mean each contract for such sales has a Section 2.83(d) condition imposed?

4. Is Section 2.83(d) intended to apply to all small producer certificates issued since the effective date of Order No. 539, or to all small producer sales initiated since that date?

Totally unclear from Order No. 539-A is which small producer sales, if any, are covered since these small producers each had their certificates prior to the issuance of Order No. 539. What is distressing and discouraging to these small producers is that, based on representations

in Order No. 428 and 18 C.F.R. 157.40, they have obtained small producer certificates and are making sales in interstate commerce. Now, with the emergence of Order No. 539-A and Section 2.83(d), the Commission appears to be changing the ground rules under which these sales, in good faith, were made. At the time we either received our small producer certificates or commenced jurisdictional sales we had no idea that our delivery obligation would be anything other than that contained in our contracts.

5. If Section 2.83(d) does apply to small producers when do they have an opportunity to notify the Commission that they do not accept an Order No. 539-A condition?

Unlike larger producers who have to file for a Section 7 certificate and have an opportunity to reject an Order No. 539-A condition, small producers under Section 2.83(d) as written are not afforded such an opportunity.

Whatever the opportunity, if small producers alone refused to accept an Order No. 539-A condition on each sale, there is the possibility there could be in the range of about 20-30,000 [8] hearings at the Commission. In fact, the prospect of such a burden goes a long way toward discouraging the dedication of gas to interstate commerce and encouraging producers to look for gas properties where the gas can be sold in other markets.

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VI.

Comments to Questions Posed in Order No. 539-A

These small producers' response to the questions posed on page 11 of Order No. 539 is as follows:

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[8] Based on an estimated 6,000 producers having four to five contracts each to sell gas in interstate commerce.

1. We have not and do not consider the *purchaser's* take-or-pay provision in a gas sales contract as a delivery obligation of the producer.

2. The delivery obligation under the typical gas sales contract is the delivery of 100 percent of the gas actually produced, less lease reservations, from existing wells on the contract acreage subject to the sole discretion of the producer, as a "reasonable prudent operator," to make all operating decisions.

3. Under typical gas sales contracts producers are not required to deliver any specified volume of gas over a set period of time.

4. As discussed earlier, the Commission cannot and should not impose any delivery obligation which substitutes for or expands the producer's obligation under its contract. Similarly, the Commission cannot and should not substitute its judgment for the producers' contractual right and obligation to make, in its sole discretion, operating decisions of a reasonable prudent operator.

5. Aside from the dubious nature of Commission authority to order producers to execute only a specific type of contract containing uniform dedication and delivery provisions, these small producers think such a form contract is unwise and unnecessary. Our contracts and the typical gas sales contract contain clear delivery and dedication provisions. The only thing that is unclear about a producer's delivery obligation is the Commission's intent in issuing Order Nos. 539 and 539-A. All that is needed to clear up this confusion is a clear, unambiguous statement that the Commission does not consider a producer's delivery obligation to be anything other than that contained in the producer's contracts.

One additional reason not to adopt a standard producer contract is that it would limit the flexibility of the contracting parties to tailor each contract as the circumstances dictate or warrant.

6. The reporting requirements of Subsection 2.83(d) not only are unfair, unduly burdensome and contrary to

the precepts of small producer exemption but they also will not provide useful data to the Commission. As explained above, Subsection 2.83(d) requires much data not required by our contracts and not in our possession, and apparently is

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based on the notion that take-or-pay provision sets a delivery obligation, and ignores the contractual reservation of gas for lease operations. We submit a better course of action is to eliminate Section 2.83.

7. It is our firm belief that there is no reason for the Commission to issue Order Nos. 539 and 539-A and there is no reason to require any producer to submit production data in the manner required by Section 2.83(d). To the extent the Commission ultimately decides to require the submission of production data, any data filed that is of a confidential or proprietary nature must and should be kept confidential.

8. The state regulatory agencies in the states where we conduct gas operations and the USGS each have the specific jurisdiction, capability, and existing personnel to monitor our production than does the Federal Power Commission. As we demonstrated above, it is this very jurisdiction of the states and the Department of Interior's USGS that makes it clear that this Commission does not have the authority over production activities it is asserting herein.

VII.

For the reasons stated above, Abercrombie, Coquina, Cotton, C&K, Tipperary and Texasgulf respectfully request that Section 2.83(d) be rescinded. We further request that the Commission clear up the confusion and uncertainty caused by Order Nos. 539 and 539-A by clearly and expressly stating that the sole delivery obligation a producer has is that under the standard producer contract.

Finally, these small producers urge that even if the Commission adopts Subsection 2.83(d) that the Commission exempt small producers.

Respectfully submitted

/s/ Bruce F. Kiely
GORDON GOOCH
BRUCE F. KIELY
BAKER & BOTTS
1701 Pennsylvania Ave., N.W.
Washington, D.C. 20006

Attorneys for
J. S. ABERCROMBIE, C & K PETROLEUM COMPANY, INC., COQUINA OIL CORPORATION, COTTON PETROLEUM COMPANY, TIPPERARY CORPORATION AND TEXASGULF INC.

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UNITED STATES OF AMERICA

DISTRICT OF COLUMBIA

BEFORE ME, the undersigned authority, on this day personally appeared in said District BRUCE F. KIELY, who after first being duly sworn, on his oath deposed and said: That he is an attorney for J. S. ABERCROMBIE, C & K PETROLEUM COMPANY, INC., COQUINA OIL CORPORATION, COTTON PETROLEUM COMPANY AND TEXASGULF INC.; that as such has signed the foregoing document; that he is authorized to do so; that he has read said document and is familiar with the contents thereof; and that the matters and things set forth therein are true and correct to the best of his knowledge, information and belief.

/s/ Bruce F. Kiely
BRUCE F. KIELY

SUBSCRIBED and SWORN TO BEFORE ME this 19th day of April, 1976.

/s/ Dorothy L. Sampson
Notary Public In and For
The District of Columbia

My Commission expires Feb. 28, 1981.

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BEFORE THE
FEDERAL POWER COMMISSION
WASHINGTON, D.C. 20426

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Service Under Certificated Arrangements	))))	Docket No. RM76-8

COMMENTS OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA IN RESPONSE TO COMMISSION ORDER NO. 539-A

Now comes Interstate Natural Gas Association of America (INGAA) and in response to Order No. 539-A issued herein on March 26, 1976, submits the following comments:

I

While the Commission in Order No. 539-A has attempted to clarify the intent and purpose of Order No. 539, it regrettably has failed adequately to do so and the same vexing problems spawned by Order No. 539 exist today as they did before Order No. 539-A was issued. INGAA recognizes the Commission's concern for using every reasonable means within the four corners of the Natural Gas Act to strengthen and improve the gas supplies available to the interstate markets. The interstate pipeline members of INGAA are as deeply concerned as the Commission in achieving these objectives. Unfortunately, the Commission in Order No. 539 has created a major roadblock to developing new supplies and in bringing in new gas for consumers served by the vast interstate pipeline network in this country. The fact of the matter is that Order 539 has constituted a considerable impediment to the connection of new gas supplies for interstate pipelines since its date of issuance.

The reason for this is plain—no producer wants to accept a certificate conditioned by Sec. 2.83(d) requiring it to agree, even before gas is sold or fields are fully developed, to some unknown and indeterminable "certificated minimum daily delivery obligation" (See § 2.83(d), Order No. 539-A, Mimeo cy. p. 13). As INGAA pointed out in its Application For Rehearing of Order No. 539 filed herein on November 14, 1975, and as the producers have demonstrated in their filings, such a concept is foreign to the historical, long-accepted contractual relationships between pipelines and producers for the purchase of natural gas and reflects a complete misunderstanding of the purpose and intent of such contracts.

At page 10 of Order No. 539-A the Commission states: "The parties imply in their responses that gas sales contracts do not contain any delivery obligations whatsoever." It then concludes that to remove any ambiguities ". . . it proposes to amend its General Policy and Interpretations by adding a new section regarding the obligations of parties accepting a certificate of

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public convenience and necessity from this Commission." (Id. at 10). The Commission, INGAA submits, has misconstrued the thrust of the comments made. No one, to the best of our knowledge, has made any claim or assertion that gas sales contracts do not contain any delivery obligations whatsoever. If such assertion has been made it is simply not the fact. There is a clear and definite obligation on the seller to deliver all available gas covered under particular contracts, in accordance with the terms of the contracts. This is a legally enforceable obligation which a pipeline purchaser can and should pursue if the producer seller fails to live up to the contract terms. The confusion and uncertainty arises from the Commission's insistence on improperly translating these contractual delivery obligations into a "certificated minimum daily delivery obligation of the seller." The Commission is painting black stripes on a white horse and calling it a

zebra and it is no such animal. If the interstate pipelines are going to be able expeditiously to connect new supplies of gas, the Commission has to recognize the error of its approach here. Furthermore, it seems obvious that the Commission is proceeding on the mistaken belief and completely unsupported assumption that producers are withholding gas from the interstate pipelines and not living up to their contract obligations to deliver gas. This is a wholly unfounded premise and one which has infected this entire matter. There is no truth to the "withholding" charge and the Commission cites no instance where producers have not carried out their contract obligations insofar as delivering available gas is concerned. At a time when interstate pipelines are seeking every feasible, legitimate opportunity to connect new gas, it is inconceivable that the Commission would throw another obstacle in their way. Yet that is precisely what happened with the issuance of Order No. 539, and again with the issuance of Order No. 539-A. Order No. 539-A does not reach or resolve the heart of the problem but only obfuscates the matter further. Now the Commission proposes by rulemaking what is already in being and which is causing such serious problems. INGAA, therefore, welcomes the opportunity to present oral argument to the Commission on these important issues and proposes to do so.[1] We urge the Commission to reconsider its position here and withdraw the onerous provisions of Sec. 2.83(d) relating to a "certificated minimum daily delivery obligation of the seller."

II

The Commission raises several questions in Order No. 539-A (mimeo cy. p. 11) which it invites parties to discuss in their responses to the Order. Without in any way departing from our position regarding the legality and

[1] By separate Notice filed today with the Secretary, INGAA has advised the Commission of its intention to appear for oral argument.

propriety of the instant rule, INGAA submits the following responses for the Commission's consideration:

"1. Whether the daily contract quantity provision or take or pay provision found in many contracts are considered by the parties to the contract to constitute a delivery obligation?"

Without resorting to the legal axiom that a contract speaks for itself, it could be said as a general proposition that if a contract contains a *specific* daily contract quantity, it would be considered a delivery obligation, assuming there were no other qualifying provisions. Take or pay provisions on the other hand are not delivery obligations and are not so considered by the parties.

The difficulty in all of this, as we have said before, is that the Commission is attempting to read something into sales contracts which is not there. Under the standard "dedication of reserves" type of contract, the sellers' basic obligation is to sell and deliver such quantities *as are available* from the dedicated reserves under the contract, and requested by buyer. And, the standard type of contract reserves to the seller, among other things, the sole discretion as to development and operation of his properties, but usually subject to the standard of prudent operating practices. In general the seller must deliver and sell, in accordance with the terms of the contract, whatever volumes the buyer requests up to the volume the seller is capable of delivering from his wells so long as the reservoir is not damaged and applicable conservation regulations are not violated. The reserve dedication form of gas sales contracts is one drawn expressly recognizing the physical aspects of the asset involved:

—Reserve estimation is an art, not a science, and

—Because natural gas is a wasting asset, constant production levels cannot be maintained through the life of the reserves;

—Hence, neither the total level of reserves involved nor a specific daily level of delivery are guaranteed in this form of contract.

Thus, contrary to the Commission's belief, a pipeline would generally not have a contract claim against a producer for failure to deliver specific daily volumes unless it could demonstrate that the producer was not delivering all available volumes or was not operating in a prudent manner. Moreover, the growing quantity provisions of contracts vary considerably, from field

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to field, region to region, as between particular buyers and sellers, and even within the same field and/or reservoir, depending on the terms negotiated between the producer and the pipeline. Numerous factors and circumstances come into play in reaching final agreement, none of which lend themselves in all instances to quantification.

A typical contract delivery provision may state that

> "Seller shall not be obligated to deliver on any one day a volume of gas from any well in excess of Seller's ability to produce and deliver having due regard to reasonable and normal operation and production practices, but Seller shall perform in conformity with good production practice all obligations of this Agreement with respect to the operation and maintenance of said well."

or, in some instances it may be described in this way:

> "The term "daily contract quantity" shall mean the average daily quantity of gas which Buyer is obligated to purchase and entitled to receive from Seller hereunder *in order to equal the annual quantities* provided for in Section (1), Article VI hereof." (emphasis ours)

Because of the exhaustible nature of the resource and its geological characteristics many contracts will provide that

> "The obligations of Seller hereunder are subject to the ability of Seller's wells to produce without waste and in accordance with prudent oil and gas field practice, and Seller shall not be required to produce any well in excess of the maximum rate of flow fixed by law or regulatory body or in excess of the maximum efficient rate of flow of such well as determined by Seller, whichever is smaller. Seller reserves the right to operate its leases covered hereby free from any control by Buyer and in such manner as Seller, in its sole discretion, may deem advisable, including, without limitation, the right to determine when, where or whether to drill new wells, to repair or rework old wells and to abandon any well or surrender any lease or leases when no longer deemed by Seller to be capable of producing gas in paying quantities."

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These are but a few of the myriad of "delivery" provisions that come into play in determining a producer's obligation to deliver gas to a pipeline buyer. Many others could be cited. The important point is that such contracts do not specify a "minimum daily delivery obligation" such as that contemplated by Sec. 2.83(d), and though the Commission in Order No. 539-A has attempted to mitigate the concerns of the parties herein by asserting that Order 539 ". . . does not impose upon them [petitioners] any obligations or duties other than those imposed in their contracts and certificates." (Mimeo cy. p. 6), the clear wording of Sec. 2.83(d) is otherwise.

Faced with a certificate conditioned in this manner a producer has little choice; either he refuses the certificate because there is no way of determining what his certificated minimum daily delivery obligation is at this time, or he protests and must go through the hearing process with its attendant delays and uncertainties.[2]

[2] At one time the Commission considered imposing daily contract quantity requirements in producer contracts but decided against

The take or pay obligation of a pipeline in standard producer-type contracts is a minimum purchase obligation of the pipeline and not a minimum delivery obligation of the seller. It could not in any way be properly construed as a minimum delivery obligation imposed on the seller. The obligation is basically that of the buyer.

"2. If a contract does not contain a daily contract quantity provision or a take or pay provision, what other provision, if any, governs delivery?"

This question has largely been answered in the response to Question 1 above. There are numerous provisions in sales contracts which bear upon

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or govern the delivery of gas. Some of them we have cited above. Perhaps the most common provision is one that expressly states that the quantities of gas provided for there are subject to the *availability* of gas for delivery. Such provision is often accompanied by provisions covering adjustments in delivery volumes on a monthly and/or annual basis and also adjustments brought about by redeterminations of reserves dedicated under the contract. In fields pro-rated by a state regulatory agency, the contract quantity for a well located in such field will be the allowable assigned to such well by the state agency, generally on a monthly basis. If a well is located in a field not pro-rated by a regulatory agency, the contract quantity for such well is generally a calculated figure, based on a formula designed to produce the reserves over

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such action. See Docket No. R-199, Non-acceptability of Contracts Between Independent Producers and Interstate Natural Gas Companies Containing Certain Provisions in Daily-Contract-Quantity and Take-or Pay-for Clauses, Order No. 334, Prescribing Certain Make-up Provisions, issued January 18, 1967 (37 FPC 110). There the Commission was concerned with pipelines being required to buy too much gas rather than not enough. As a matter of fact, the concern of many pipelines today is the effort of producers to maximize production rather than holding back as has been charged.

the term of the contract. The contract provisions pertaining to such situations will usually provide that the applicable contract quantity determined as above for any given well is utilized to determine the minimum annual purchase obligation of the pipeline and the maximum annual delivery obligation of the seller. Since performance is measured on an annual basis, the production on any given day or for any given month does not demonstrate compliance or non-compliance with contract obligations. The Commission is probably in the best position to determine from contracts already on file the various kind of contract provisions which govern the delivery of gas. INGAA is confident that contracts specifying a minimum daily contract quantity are the exception and not the rule.

"3. Do any of these provisions provide for a specific volume of deliveries over a set period of time?"

Some do and some do not. See above answer to Question No. 2. Certain contracts, especially newer ones in offshore areas, contain provisions for calculating the seller's daily delivery capacity from the well or wells covered by the contract from which the seller's *annual* delivery obligation may be determined. But these are uncertain amounts and could not fairly be construed as providing for a "specific volume of deliveries". Actually, the real problem facing the pipelines today is not what is provided for in existing contracts, since they speak for themselves, but the uncertainty surrounding new contracts for new reserves because of the daily delivery cloud created by Sec. 2.83(d). Until it is removed, the pipelines' ability to contract for new supplies is significantly handicapped.

"4. If a contract contains no delivery obligation, should the Commission require one?"

No, if it means a certificated minimum daily delivery obligation. The producer's obligation to deliver and the pipeline's obligation to purchase are always spelled out

in the contract between the two and it is the *sale* under this

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contract which is certificated by the Commission. The Commission should not attempt to prescribe daily delivery obligations on the parties that are beyond the scope of the agreement reached. The Commission, of course, can either approve or disapprove a contract for sale and it can attach to a certificate such *reasonable* terms and conditions as, in its judgment, are required by the public interest. This does not, however, give the Commission license to re-write the contract or to impose terms and conditions which are beyond the scope of the contract and, we submit, beyond the authority of the Commission to impose.

Furthermore, imposition of a minimum daily contract quantity could be seriously at odds with announced Commission conservation policies and its formal urging of pipelines to husband gas reserves. Nowhere in Order No. 539-A does the Commission address this important public policy question or attempt to reconcile this conflict.

The Commission's responsibilities under the Natural Gas Act run deeper than the simple enforcement of contract obligations. The Commission is charged with determining the public interest which includes consideration of long-term detriments and benefits as well as short term gains. For example, not all pipelines are curtailing into high priority markets and any action which would force greater deliveries by producers would simply serve low priority markets today at the expense of high priority markets tomorrow.

In order No. 431 issued on April 15, 1971, the Commission directed jurisdictional pipeline companies to "take all steps necessary for the protection of as reliable and adequate service as present supplies and capacities will permit . . . including injection into storage in anticipation of the heating season." Clearly, the intent here was to conserve gas during off peak periods to insure deliverability during high priority peak load demands.

One step complementary to and consistent with storage injections is gas conservation through husbanding of gas supplies.

In Order No. 498, issued December 31, 1973, the Commission specifically requested "that all natural gas pipeline companies, where possible, husband present supplies of natural gas for high priority usage . . .".

To the extent permitted by gas purchase contracts, some pipelines with gas available after filling storage and meeting high priority uses have exercised the option of "banking" gas for future high priority uses by cutting back their gas takes in those fields where contracts permit and loss of gas or drainage will not occur rather than taking the gas and selling it for low priority uses.

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As noted above, both storage injections and husbanding are in step with the purpose of Order No. 431 and Order No. 498. However, a literal reading of the policy announced by Order No. 539 may encourage complaints to the Commission and perhaps legal action aimed at prohibiting conservation through storage, retaining stored gas for high priority use, and husbanding. Specifically that portion of the statement of policy which commands all natural gas pipeline companies to "comply with all deliverability . . . requirements to meet . . . certificated . . . quantities, volumes or sales", may be read as prohibiting pipelines from carrying out such conservation policies which are otherwise consistent with sound operating practices and procedures and the Commission's policy as expressed in Order No. 431 and Order No. 498. Certainly, it cannot be the Commission's intent to require pipelines to forego storage injections in order to meet certificated requirements or to force withdrawal from storage to meet certificated volumes on warm winter days when the gas withdrawn will serve low priority uses and the withdrawal will exhaust storage fields to the subsequent detriment of high priority uses. To adequately protect high priority uses, pipelines must be able to inject

gas into storage, to retain the same and husband gas supplies, even if such actions require curtailment of low priority uses served within certificated volumes.

INGAA respectfully submits that Order No. 539 will have the effect of discouraging conservation efforts contrary to established Commission policy. For this reason alone the Orders herein should be rescinded. At the very least they militate against requiring a minimum daily delivery obligation as now embodied in Sec. 2.83(d).

"5. What is the feasibility of using a uniform contract form for the dedication and delivery provisions?"

The imposition of a uniform contract form would be completely unworkable and could lead to far more problems than it could possibly solve. Any such form would have to recognize the various operating conditions of the pipelines and consequently would have to be so general as to be totally useless. Gas purchase contracts are tailored to the particular circumstances and conditions surrounding the individual sale. They necessarily differ in different areas because of the wide variety of physical characteristics of producing fields. The extremely tight formations of the San Juan Basin differ markedly from the domal formations found offshore and these in turn are far different from the shallow sands of the Hugoton field. There are dry gas fields and wet gas fields—associated and non-associated; all with different producing—and delivery—characteristics which are taken into account by the parties in negotiating a gas purchase contract and in setting the terms. To try to pour this into a mold to fit all circumstances would

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create a monstrous situation which neither the Commission, the industry, nor the consuming public could live with. Furthermore, the Commission would be injecting itself improperly into the private domain of the contracting parties and inhibiting their freedom of negotiation. The Supreme Court has held that

> "The Natural Gas Act . . . recognizes the need for private contracts of varying terms and expressly provides for the filing of such contracts as a part of the rate schedules." *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 345, 100 L.Ed. 373, 387 (1956).

Imposing a uniform contract form for the dedication and delivery provisions in gas purchase contracts, INGAA submits, would be beyond the Commission's authority and impermissible.

"6. Do the reporting requirements of Subsection 2.83(d) represent the best method of providing the Commission with the data necessary to enforce the policy stated in Order 539?"

Consistent with INGAA's position stated above, and because of the ambiguities and uncertainties created by Sec. 2.83(d), the reporting requirements cannot reasonably be evaluated.

"7. Should the information required to be submitted pursuant to Section 2.83(d) be kept confidential?"

Producer respondents are better able to answer this question than INGAA.

"8. The extent to which other Federal or state agencies have jurisdiction and exercise oversight of production in a manner capable of attaining the objectives sought by the Commission."

Production of oil and gas has long been the concern of the producing states and it is an activity expressly exempted from the Commission's jurisdiction by Sec. 1(b) of the Natural Gas Act (15 USC 717(b)). Prevention of waste and orderly development of resources have been the primary aim of the various state and Federal regulatory bodies having control and past experience has demonstrated the efficacy of this approach. This is an area

which Congress has wisely left to the states and the states have met the

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challenge. The Interstate Oil Compact Commission, a Congressionally approved, voluntary cooperative effort to conserve oil and gas by the prevention of physical waste thereof from any cause, has been an effective aid in this regard since its inception in 1935. There is thus no need or room for Federal intrusion into this local activity. Similarly, the Department of Interior as the guardian of the Federal domain exercises conservation policies which have served this Nation well. Order No. 539 would impinge on all of these activities and impose production requirements which could be inconsistent with the sound conservation measures adopted by the states and the Department of Interior and which have been in force over these many years.

CONCLUSION

INGAA, as the representative of practically all of the major interstate natural gas pipelines subject to the Commission's jurisdiction, is deeply concerned over Order Nos. 539 and 539-A and strongly recommends that the Commission withdraw same and terminate this proceeding. At the very least Sec. 2.83(d) should be deleted. These orders would unlawfully impose minimum daily delivery obligations on producers and pipelines which are neither physically nor legally capable of being fulfilled and which run contrary to the sound development and utilization of our limited reserves of natural gas. For the reasons stated previously here, INGAA believes the Commission's action is not in the public interest and is contrary to the aims and objectives of the Natural Gas Act.

The name, title and mailing address of the person to whom correspondence with regard to this matter should be addressed is:

Jerome J. McGrath, Executive Vice President and
General Counsel
Interstate Natural Gas Association of America
1660 L Street, N.W.
Washington, D.C. 20036

Respectfully submitted,

INTERSTATE NATURAL GAS
ASSOCIATION OF AMERICA

By /s/ Jerome J. McGrath
JEROME J. MCGRATH

Washington, D.C.
April 19, 1976

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April 19, 1976

Mr. Kenneth F. Plumb, Secretary
Federal Power Commission
825 North Capitol Street, N.E.
Washington, D.C. 20426

Re: Docket No. RM76-8, Policy with Respect to Enforcement of Deliverability and Rendition of Natural Gas Service Under Certificated Arrangements: Order No. 539-A

Dear Mr. Plumb:

Natural Gas Pipeline Company of America (Natural) is a natural gas company subject to the jurisdiction of this Commission. It owns and operates an interstate natural gas transmission system extending from New Mexico, Texas and Louisiana, to termini near Chicago, Illinois, and sells natural gas to local distribution companies for resale to municipalities and utility companies in the States of Texas, Oklahoma, Kansas, Nebraska, Iowa, Wisconsin, Illinois, Indiana and Missouri.

NAPECO, INC. is engaged in the sale of natural gas in interstate commerce for resale and is a natural gas company subject to the jurisdiction of the Commission. NAPECO, INC. is a wholly-owned subsidiary of Natural. Pursuant to Orders of the Commission issued August 3, 1973 and August 2, 1974 in Docket No. RP73-63, all gas discovered or developed by NAPECO, INC. is to be sold to Natural.

Natural and NAPECO, INC. ask that correspondence in regard to this application be addressed to the following:

J. I. Poole, Jr.
Vice President,
Marketing-Rates
Natural Gas Pipeline Company
of America
122 South Michigan Avenue
Chicago, Illinois 60603

Joseph M. Wells
Paul E. Goldstein
Arthur S. Kallow
Suite 1825
122 South Michigan Avenue
Chicago, Illinois 60603

I

On March 26, 1976 the Commission issued Order No. 539-A, "Order Granting in Part and Denying in Part Reconsideration, Clarifying Order No. 539, Denying Stay, Noticing of Proposed Rulemaking, Noticing of Oral Argument and Granting Intervention" in the referenced docket. Order No. 539, "Promulgating Statement of Policy", issued on October 14, 1975, without hearing or notice or opportunity for comment, basically stated that all natural gas companies must comply with

> all deliverability or production of natural gas requirements to meet, *inter alia*, certificated operations, services, developments, quantities, volumes or sales. (*Id.*, *mimeo* at 9.)

Order No. 539 promulgated Section 2.83 of the Commission's General Policy and Interpretations which in part states various enforcement procedures, including Commission actions on its own motion and as a result of complaints filed by others. Natural and NAPECO, INC. filed a Joint Application for Rehearing and Reconsideration of Order No. 539 on November 13, 1975.

II

Order No. 539-A *inter alia* gave notice of a proposed rulemaking to amend the Commission's General Policy and Interpretations by adding a new section regarding the obligations of parties accepting certificates of public convenience and necessity. Order No. 539-A (*mimeo* at 11) asked for comments

regarding eight issues concerning certificate obligations. Natural and NAPECO, INC. herewith submit the following comments regarding those eight issues:

1. Whether the daily contract quantity provisions or take or pay provision found in many contracts are considered by the parties to the contract to constitute a delivery obligation?

2. If a contract does not contain a daily contract quantity provision or a take or pay provision, what other provision, if any, gove[illegible] delivery?

3. Do any of these provisions [illegible]ovide for a specific volume of deliveries over a set period of time?

Although gas purchase contracts vary considerably and each must be individually examined, in general, it can be said that producer gas purchase contracts dedicate the reserves identified in the contracts to the pipeline buyer and provide for delivery of those reserves. Historically, each pipeline has had a need for at least a rough estimate of the quantity of gas so dedicated in order to calculate the reserve life of its gas supply so that it could make financial plans as well as plans regarding service to its customers. Also, the pipeline uses such reserve estimate to determine the economic feasibility of extending its facilities to receive the gas. Likewise, the producer needs to know the average amount of gas the pipeline would be required to accept in order that the producer could evaluate and maintain a balanced cash flow. The daily contract quantity usually is a ratio of reserves obtained by dividing the quantity of estimated recoverable reserves by a number approximately equal to the number of days of the contract. Thus, for example, a typical contract would provide for 1/7300 of the reserve to be the "daily contract quantity". The "take or pay" provisions were designed to obligate the buyer within the terms of the contract to accept the

daily contract quantity of gas tendered for delivery by the seller or else to pay for such gas as if taken.[1]

The agreement on the part of the producer/seller to deliver the daily contract quantity is framed in the context of the "prudent operator standard", expressed, for example as

> Seller's obligation to deliver gas shall be subject to the ability of Seller's wells to produce without waste and in accordance with prudent oil and gas field practice.

Basically, this standard requires the producer to act as a prudent operator in producing the gas dedicated by the gas purchase contract. It is in the mutual interest of the producer and pipeline that each field be produced in a prudent and unwasteful manner. Gas purchase contracts thus do contain obligations on the part of the producer to deliver gas to the pipeline. The obligation to deliver, while not a warranty provision with specified quantities required to be delivered, is certainly legally enforceable should the producer fail to deliver in compliance with the standards contained in the contract.

4. If a contract contains no delivery obligation, should the Commission require one?

As we have just stated, contracts usually do contain some delivery requirements. An additional Commission-imposed delivery obligation would create uncertainty and because of its chilling effect would tend to discourage producers from selling gas in the interstate market.

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[1] In contrast to the previously mentioned provisions, some recent contracts—especially those for offshore reserves—define quantity in terms of a percent of the maximum available gas that the seller is capable of producing. The "deliverability" is determined by tests performed from time to time upon the wells.

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Delivery and other terms and conditions embodied in a gas purchase contract are the result of negotiations undertaken with an understanding based on experience of the operational and economic pressures involved in gas supply acquisitions and delivery. Pipelines have many years of experience in dealing with their own day-to-day gas supply needs in the context of their existing contracts. To force a pipeline to take an arbitrary quantity on a given day would reduce the pipeline's flexibility to manage its own supply and operate efficiently. In short, both the producers' and pipelines' day-to-day operating problems would be complicated by Section 2.83.

The chilling effect likely to result from "rewriting" delivery obligations is borne out by the fact that Natural has already had several experiences with gas producers who have cited Order No. 539 as a major factor in refusing to connect much needed gas supplies to Natural. In the following instances, producers have not accepted Commission certificates to sell gas to Natural pursuant to executed and valid gas purchase contracts where such certificates were in part conditioned upon Order No. 539:

a. Burmah Oil Development, Inc. (Burmah) has not accepted a certificate to sell gas to Natural from Offshore Louisiana, East Cameron Blocks 322 and 323, pursuant to a contract dated September 18, 1975. Burmah advised Natural that a major factor in Burmah's decision was the imposition of Order No. 539 conditions within the certificate.

b. Mobil Oil Corporation (Mobil) has not accepted a certificate to sell gas to Natural from offshore Louisiana, West Cameron Blocks 532 and 533, pursuant to a contract dated June 18, 1975. Mobil has advised Natural that a major factor in Mobil's decision was the Order No. 539 conditions in the certificate.

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c. Chevron Oil Company (Chevron) has not accepted a certificate to sell gas to Natural from Offshore Louisiana, West Cameron Blocks 532 and 533, pursuant to a gas purchase contract dated September 23, 1975. Chevron has advised Natural that a major factor in Chevron's decision was the Order No. 539 conditions in the certificate.

5. What is the feasibility of using a uniform contract form for the dedication and delivery provisions?

It is infeasible to use a uniform contract for dedication and delivery provisions. Each gas purchase contract is negotiated according to the particular circumstances relevant to the gas being sold. Each contract is fashioned to meet the needs of the buyer and seller in the context of the operational and geological constraints present. For example, it would be impossible to predict the quantity of gas deliverable under a casing head gas contract. The very nature of casinghead gas makes it impossible to promise or to demand specific quantities at particular times. Also, as stated above, sometimes parties have agreed that percent deliverability obligations are preferable when deliverability may change rapidly—even on a day-to-day basis due to engineering or geological factors.

Thus one or even several form dedication and delivery provisions could never deal with the complex and subtle factors which must be considered and provided for according to each set of circumstances.

6. Do the reporting requirements of Subsection 2.83(d) represent the best method of providing the Commission with the data necessary to enforce the policy stated in Order No. 539?

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7. Should the information required to be submitted pursuant to Section 2.83(d) be kept confidential?

Subsection 2.83(d) is deleterious to the interests of attaching additional gas supplies to the interstate market.

However, in the event such reporting requirements are deemed necessary, Natural and NAPECO, INC. urge that the data so reported be kept confidential by the Commission. Reserve determination information is usually a result of lengthy and thorough geological and engineering analyses. Each reserve determination thus reflects not only a significant financial expenditure, but an invaluable judgment on the part of the experts involved. There are circumstances where divulging the reserve information without the company's permission would be un uncompensated taking and would make private property available to competitors unfairly.

8. The extent to which other Federal or state agencies have jurisdiction and exercise oversight of production in a manner capable of attaining the objectives sought by the Commission.

State statutes and regulations have traditionally and effectively dealt with problems of waste and prudent development of gas. Also, there is case law regarding the concept of the "prudent operation" of gas reserves. In the federal domain, existing statutes and regulations also provide for prevention of waste as well as conservation of gas. *See e.g.* Outer Continental Shelf Lands Act, 43 U.S.C.A. § 1334(a)(1), which delegates the duty of prescribing regulations concerning waste and conservation on the outer continental shelf to the Secretary of the Interior.

III

Natural and NAPECO, INC. are aware that the Interstate Natural Gas Association of America (INGAA) will timely file comments in this docket on behalf of its members. Natural and NAPECO, INC. support such comments of INGAA.

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IV

CONCLUSION

Section 2.83 or any similar provision is likely to impede timely development and dedication of gas reserves to the interstate market. Natural and NAPECO, INC. therefore urge that Section 2.83 be withdrawn and that no new section with a similar effect be promulgated.

Respectfully submitted,

NATURAL GAS PIPELINE COMPANY OF AMERICA

NAPECO, INC.

By /s/ LeRoy F. Busa
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• • • •

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Service Under Certificated Arrangements	))))	Docket No. RM76-8

COMMENTS OF PENNZOIL COMPANY, ET AL.*

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Services Under Certificated Arrangements	))))	Docket No. RM76-8

COMMENTS OF PENNZOIL COMPANY, *ET AL*[1]

While Pennzoil has difficulty with the precise scope, intent, purpose and basis of Order Nos. 539 and 539-A, caused mainly by the vagueness and ambiguity in both the textual portions of those orders and in the new Section 2.83(d) imposed by those orders, Pennzoil firmly [illegible]s on both legal and policy grounds the apparent thrust of those orders.[2]

I.

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---

[1] Pennzoil Company, Pennzoil Producing Company, Pennzoil Offshore Gas Operators, Inc. and Pennzoil Louisiana and Texas Offshore, Inc., herein collectively referred to as "Pennzoil."

[2] Pennzoil generally joins in the comments of the Joint Comments of Indicated Producers and files these comments to supplement and amplify those comments.

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II.

Because of the unusual degree of vagueness in Orders 539 and 539-A we cannot be absolutely sure of our interpretation of those orders. However, as best as we can determine, the Commission appears to:

(a) Believe gas sale contracts impose some minimum delivery obligation on producers over and above the obligation producers believe they have agreed to assume.

(b) Believe certificates issued by the Commission either (1) impose on producers a delivery obligation consistent with the Commission's view as to the contractual obligation undertaken by the producers even though that view does not coincide with the view of the producers or (2) impose a greater delivery obligation on producers than producers have undertaken regardless of what the Commission's view of the contract obligations is.

(c) Question whether, if it is incorrect in its beliefs described in (a) and (b), the Commission should include in certificates conditions which impose delivery obligations in excess of those contractually agreed to by producers.

If we have correctly stated the Commission's beliefs in (a) and (b) above, the Commission is clearly in error in those beliefs. Finally, we are convinced the answer to the question posed in (c) above is "No."

We will discuss each of those points in order and, in doing so, will attempt to avoid unnecessarily repeating the points discussed in the Joint Comments of Indicated Producers. Finally, we will discuss two specific points concerning Order 539-A.

III.

The Commission Appears to Confuse Pipeline Obligations and Producer Obligations to Lessors With Producer Delivery Obligations

In order to illustrate the points we will make in this discussion and to provide the Commission with concrete examples and evidence, we are attaching as Exhibit A hereto an existing contract between Pennzoil Offshore Gas Operators, Inc. and United

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Gas Pipe Line Company which Pennzoil believes is more or less representative of contractual delivery obligations in recent years.[3]

A. *Pipeline Obligations to Producers*

Gas sale contracts typically include a so-called "take or pay" obligation, *i.e.*, an obligation on the pipeline to take or pay for a specified volume of gas over a given period of time, *e.g.*, one month or one year. That obligation is solely an obligation of the pipeline and is not an express or implied obligation on the producer.

A reference to Exhibit A makes this point quite clear. Section 1A of Article VIII of Exhibit A, which is entitled "Annual Minimum Quantity *Purchase* Obligation,"[4] states (second sentence): ". . . Buyer agrees to take from Seller hereunder during each Contract Year or to pay Seller for, whether taken or not, quantities of Gas Well Gas which are equal at least to the Annual Minimum Quantity for such Contract Year." Annual Minimum Quantity is defined (Art. I(7)) as the sum of the Daily Minimum Quantities for such Contract Year. Daily Minimum Quantity is defined (Art. I(7)) as a percentage of De-

[3] Pennzoil does have older contracts with varying terms. To the extent those terms with respect to delivery obligations vary materially from those in Exhibit A, then the certificates covering those contracts authorize service in accordance with such terms. See textual discussion *infra*. In any event, they are not germane to the issue of whether Sec. 2.83(d) conditions should be imposed in future certificates covering contracts such as Exhibits A.

[4] Emphasis added throughout unless otherwise indicated.

livery Capacity. Finally, Delivery Capacity is defined (Art. I(5)) as[5] the maximum volume as established by test which can be produced from the wells[6] and which is available for delivery but provided that if on any day the producer is unable to deliver the Delivery Capacity then the volume actually delivered is the Delivery Capacity for that day.

All of those provisions refer to the pipelines take or pay obligation; no one can honestly read those provisions as im-

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posing a delivery obligation on the producer.

B. *Producer Obligations to Lessors*

Producers do have obligations to lessors (whether the lessors be federal or state governments or private individuals) relating to the leasehold; those obligations arise from both express and implied covenants. Such obligations include, as a general matter, prudent and timely exploration and development of the field with a view toward assuring the lessor that it will receive adequate and timely value for the use of its land—normally money royalties or gas in kind.

State agencies and the United States Geological Survey strictly regulate producers to assure that they are operating and producing gas properly. See, *e.g.*, 43 U.S.C. § 1331, *et seq.*; 30 C.F.R. §§ 250.1, 250.34, 250.36, 250.38, 250.39, 250.40, 250.44, 250.51, 250.91 and 250.93; TEX. REV. CIV. STAT. ANN. Art. 6049c (1962).

Those obligations are contained in leases and obligate the producer to the lessor. The producer *does not* owe any of those duties to a gas purchaser unless the gas sale contract so states.

[5] Paraphrased for brevity.

[6] We emphasize that this refers to wells as they exist at the time and does not refer to the potential volumes which could be produced *if* additional wells were drilled or workovers performed, etc.

C. *Producer Delivery Obligations*

Now that we have demonstrated what the producer's delivery obligation is *not*, we turn to what the delivery obligation is. Again we refer to Exhibit A. One will search Exhibit A in vain if one attempts to find any language relating to a producer delivery obligation other than that in Article VI and in Section 2 of Article VIII. Article VI provides that, subject to certain reservations of gas set out in Article VII:

> ". . . Seller hereby agrees to sell and deliver to Buyer . . . (1) natural gas *produced* from the leases as limited and described in [an attached exhibit] . . . and (2) natural gas attributable to such leases *produced* from any units containing such leases. . . ."

Article VIII provides, in pertinent part, with respect to oil well gas only, that:

> ". . . Seller agrees that commensurate with good production and operating practices and in accordance with proper conservation measures, Seller will so operate its wells and facilities that Oil Well Gas . . . shall be available to Buyer at as uniform rates of flow and operating conditions as possible throughout each month . . ."

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To be read with those provisions, however, is Article 5 (p. 9-GT of Exhibit A) which reserves to the producer "the right to operate its properties free from any and all control by Buyer in such manner as Seller in its sole discretion may deem advisable, including, without limitation, the right to drill new or additional wells, to repair and rework old wells," etc. "Seller shall, in exercising its discretionary rights hereunder, act as a reasonably prudent operator would act under the same or similar circumstances. Seller agrees . . . in accordance with prudent operating practices, to fully develop the properties covered hereby for the production of gas."

This establishes quite clearly to even the most cursory reader that the producer does not have an obligation to *deliver* any *specific* quantity of gas over any given period of time but rather is obligated only to deliver whatever gas is produced from whatever wells exist from time to time. The producer has not agreed, for example, to a delivery rate which could result in obligating the producer to rework wells or drill new wells. There is, however, an obligation to operate and develop its properties as a reasonably prudent operator would under the same or similar circumstances (the applicable cases interpret such language to mean that the producer cannot act arbitrarily or capriciously). When so acting, the producer will necessarily produce and deliver the volumes of gas producible under prudent operating and development practices. However, that is a far cry from a so-called "specified minimum delivery obligation." As we will discuss *infra*, the authority to enforce the producer's obligation to develop and operate its properties is vested by law in other agencies and to some extent, by virtue of contract rights, in the gas purchaser; such authority is prohibited to this Commission by law.

IV.

A Certificate Does Not Impose Delivery Obligations Different From Those in the Contract Service Being Certificated

As the Commission (and, we presume, the staff personnel assisting and advising the Commission in this Docket) is well aware, producers apply to the Commission for certificates authorizing the producer to engage in a service, *i.e.*, a sale of gas for resale. The service proposed, and for which a certificate is requested, is the service proposed in the gas sale contract submitted as an exhibit to the application for a certificate.

Certificates issued by the Commission in response to such applications uniformly (until the advent of Order 539) authorized the producer to "render the service proposed" without

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any hint or indication that anyone supposed the certificate imposed a delivery obligation different from or greater than the obligation described in the contract.[7] Nor is there anything in the Natural Gas Act or the Commission's regulations indicating any such thing.[8] Under these circumstances, no reasonable person could possibly conclude that the typical certificate imposes any delivery obligation different from or greater than the producer proposed per its contract. If the Commission, after twenty-two years of producer regulation, believes in the novel proposition that the service certificated is continuing delivery of volumes delivered at the initiation of service, then it is clearly wrong and is ignoring what it has done and presided over for twenty-two years.

V.

Conditions Regulating Development and Production Operations Cannot and Should Not Be Included in Certificates

The only possible reason for requiring producers under Orders 539 and 539-A to submit reserve determinations and request certificate amendments (as now required by Sec. 2.83(d) of the regulations) is to permit the Commission to directly order producers to undertake such drilling or reworking operations as the Commission feels is necessary to meet some phantom or Commission-imposed delivery obligation (or to achieve the same result by refusing

[7] Certificates normally have contained language or conditions unrelated to this point, *e.g.*, a statement that the certificate does not negate the requirement that abandonment authorization be obtained before deliveries cease.

[8] Order 539 (mimeo at 2, 3, 6) seems to imply there is some such provision in the Natural Gas Act or the Commission's regulations but never says where. After diligent research we have been unable to find it.

to amend the certificate).[9] Such an exercise by the Commission would be both illegal and unwise.

Section 1(b) of the Natural Gas Act flatly prohibits the Commission from regulating production operations, and an order

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requiring reworking, drilling or otherwise expending funds on development or production activities is clearly outside the scope of the Commission's jurisdiction. Nor can the Commission do by indirection (specifically, by imposing certificate conditions under Section 7(e) of the Act) what it cannot do directly. See *Central West Utility Co.* v. *FPC*, 247 F.2d 306 (1957), and the discussion thereof in the Joint Comments of Indicated Producers, which we join.

The Congress has determined that regulation and oversight of development and production functions should be left to the states and to the Department of Interior and, as noted above, they are performing those functions including reviewing whether producers are operating their properties prudently. If the Commission persists in invading those functions it will be doing to not only without even color of authority but also in direct contravention of the dictates of Congress. While the Commission may *consider* production in exercising its control over sales, it cannot *regulate* production.

However, even aside from the legal barriers which prohibit such actions, there are a number of reasons why such actions are unwise. First, there is no need for the Commission directly or indirectly to regulate development and production of gas. As noted above, that job is already being performed by others. Whatever the Commission's view of the adequacy of the job being done, the

[9] If we are mistaken and the purpose is merely to assure that pipelines enforce their contracts with producers, an order simply directing the pipelines to do so would be simpler, more direct and less burdensome to both the Commission and the producers. The pipelines normally are quite energetic in following producer operations.

job is being attempted by others. There is no need to attempt to undertake the same work.

Second, such action would impose a very onerous burden on producers which already must contend with heavy regulation by state agencies and the Department of Interior including periodic filing of extensive data.

Third, we are convinced that the Commission has not considered the impact upon its own operations of Section 2.83(d). That Section will result in frequent filings of (a) voluminous reserve redetermination reports and (b) requests for certificate amendments by literally thousands of gas producers for every jurisdictional gas contract. The sheer volume will result in near paralysis of the Commission at a time when energy problems demand prompt if not immediate responses from regulators.

Fourth, the burden imposed on producers can only be a further disincentive to engage in interstate activities vis-a-vis intrastate, or even non-natural gas, activities. The interstate market can ill afford that type of regulation, and result, today. As the Commission noted in Order 539-A (mimeo 3, n.3), a number of producers have already refused to undertake jurisdictional service as a result of Order 539.

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Fifth, producers already have a very strong incentive to produce as much of their gas as possible as rapidly as possible to recover their investment and provide the necessary cash flow. This strong economic incentive is more than adequate—and is better designed than Orders 539 and 539-A—to assure rapid and full production of gas.

VI.

Two Points Require Immediate Revision or Clarification

A. Order 539-A states (mimeo at 9) that if a producer indicates it is unwilling to accept an Order 539 condition a hearing will be held and, if the Commission then decides to insert an Order 539-type condition, the producer may avail itself of Section 157.20(a) of the Regulations.

Section 157.20(a) specifically relates to pipelines and not producers. The regulations governing producers begin at § 157.23.

The Commission should indicate whether that Section becomes applicable to producers only in this limited circumstance or whether it is generally applicable. If it is generally applicable, producers should be notified that they now must take an affirmative action to accept certificates—an action heretofore considered unnecessary.

B. Section 2.83(d) provides, *inter alia*, that the "certificated minimum daily delivery obligation of the seller . . . (2) shall be without regard to any contractual reservations contrary to the certificate authorization . . ." The discussion in the text of Order No. 539-A (mimeo 6-7) leaves it extremely unclear as to whether the Commission means:

> (1) Contractual reservations of gas for lease fuel, cycling, pressure maintenance, for lessors, etc. are overriden by Order 539-A without regard to such contractual reservations and without the necessity of a specific condition to that effect in a certificate;
>
> or
>
> (2) Such contractual reservations are respected and certificated unless the certificate expressly states otherwise.

VII.

For the foregoing reasons, Pennzoil strongly urges the Commission to rescind Section 2.83(d) and to terminate Docket No.

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RM76-8 forthwith or, at the least, to clarify its intent, purposes and basis as discussed above so that intelligent

and informed decisions may be made by those subjected to Orders 539 and 539-A.

Respectfully submitted,

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THE STATE OF TEXAS)
COUNTY OF HARRIS)

Jeron Stevens, being duly sworn, deposes and says: That he is attorney for Pennzoil Company, Pennzoil Producing Company, Pennzoil Offshore Gas Operators, Inc. and Pennzoil Louisiana and Texas Operators, Inc. in the above entitled and numbered cause, that he has read the foregoing document and knows the contents thereof, and that the same are true to the best of his knowledge, information and belief.

/s/ Jeron Stevens
JERON STEVENS

SUBSCRIBED and SWORN TO BEFORE ME by the said Jeron Stevens this 15th day of April, 1976.

/s/ Valerie Meader
Notary Public in and for
Harris County, Texas
My Commission Expires
June 1, 1977

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Service Under Certificated Arrangements	))))	Docket No. RM76-8

COMMENTS OF TENNECO OIL COMPANY

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect To Enforcement Of Deliverability And Condition Of Natural Gas Service Under Certificated Arrangements	))))	Docket No. RM76-8

COMMENTS OF TENNECO OIL COMPANY

Pursuant to Ordering Paragraph (C) of Order No. 539-A issued in this docket on March 26, 1976, Tenneco Oil Company (Tenneco Oil) hereby submits its comments concerning the questions and issues raised by Order Nos. 539 and 539-A.

I.

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II.

Summary of Tenneco Oil's Position

While Order Nos. 539 and 539-A raise a multitude of questions, two fundamental and paramount questions are

presented. The first is the nature of a producer's delivery obligation under a standard contract for the sale of gas. Insofar as Tenneco Oil's contracts are concerned, the answer is clear. While the precise terms of the contracts vary, the

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delivery obligation is standard. The obligation is to deliver the amount of gas that is produced from the acreage covered by the contract as a result of the operating decisions made by Tenneco Oil in its sole discretion subject to Tenneco Oil's prior right to utilize gas for lease development and operation, related facilities operations, recovery operations, and for use by lessors as provided in the leases.[1] Of course, under long established oil and gas law, a producer cannot arbitrarily limit production but must produce the lease as a prudent operator.

The second basic question in this proceeding is whether the Commission can and should impose some delivery obligation other than the contractual obligation. Tenneco Oil firmly believes the Commission does not have the authority to impose a delivery obligation beyond that already set forth in the contracts. Furthermore, even if the Commission has the authority to impose a delivery obligation other than that undertaken in the contract, the exercise of that authority would disserve the public interest.

III.

The Contractual Obligation

Under every Tenneco Oil standard contract, the purchaser undertakes an obligation to take or pay for a quantity of gas produced from the dedicated acreage. In addition, Tenneco Oil undertakes a delivery obligation. In every contract, the purchaser's take or pay obligation is separate and distinct from Tenneco Oil's delivery obligation.

---

[1] The reservation of gas for use on the leases and in satisfaction of Tenneco Oil's lease obligations is hereinafter referred to as the lease operations reservation.

There are two basic types of purchaser take or pay provisions. Some contracts contain take or pay provisions involving reference to a specified percentage of the delivery capacity of the wells on the dedicated acreage (hereinafter referred to as delivery capacity contracts). Other contracts contain take or pay provisions involving reference to the recoverable reserves under the contract (hereinafter referred to as reserve ratio contracts). An examination of both types of contracts reveals that regardless of which type of purchaser take or pay provision is utilized, Tenneco Oil's delivery obligation is the same in every contract. Subject to the lease obligations reservation, that obligation is to deliver all of the gas *produced* from the dedicated acreage; nothing more and nothing less.

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A representative delivery capacity contract is attached hereto as Exhibit A. Section 3(c) of that contract provides that Tenneco Oil will sell and deliver per day Tenneco Oil's pro rata part of a quantity of gas well gas equal to Tenneco Oil's delivery capacity, but not in excess of Tenneco Oil's pro rata part of the quantity which can be *produced* when the wells are produced at either their respective maximum efficient rates or their allowable.[3] Under Section 1(h), delivery capacity is Tenneco Oil's "pro rata part of the maximum amount of gas well gas which can be withdrawn in any one day from the lease, under applicable rules and regulations and in accordance with prudent operating practices, and which is available for delivery. . . ." And while delivery capacity is to be initially established by test [Sections 3(a) and (b)], if the amount delivered on a specific day is less than that established by the test, then the delivery capacity is reduced to the amount actually delivered. Section 3(g).

Thus, Tenneco Oil is obligated to sell an amount equal to its delivery capacity [Section 3(c)]; and delivery

[3] Tenneco Oil's pro rata share of casinghead gas must also be delivered.

capacity cannot exceed the amount actually delivered [Section 3(g)]. Therefore, Tenneco Oil's delivery obligation cannot exceed the quantity of gas actually delivered. And since all of the gas produced from the dedicated acreage must be sold to the purchaser, the amount delivered (the delivery obligation) will be equal to the amount actually produced.[4]

The delivery obligation under those contracts which contain a reserve ratio type purchaser take or pay obligation is equally as explicit. Attached hereto as "Exhibit B" is a typical reserves ratio contract. Under Article IV, Section 2, Tenneco Oil agrees to deliver upon demand of the purchaser 125% of the "average daily quantity". The "average daily quantity" is initially established on the basis of 1 million cubic feet of gas for each 7.3 billion cubic feet of reserves located in existing wells. Article IV, Section 1. However, if Tenneco Oil cannot develop and maintain a daily deliverability of 125% of the "average daily quantity" thus established, then the average daily quantity is reduced to 80% of the actual *deliverability* Tenneco Oil can develop and maintain. Article IV, Sections

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1 and 3. Thus, the delivery obligation can not exceed 125% of the average daily quantity (Art. IV, Section 2) and the average daily quantity cannot exceed 80% of the amount which can actually be developed and maintained from existing wells (Art. IV, Section 3). Therefore, the delivery obligation is equal to 100% (125% of 80%) of the amount which Tenneco Oil can actually deliver from existing wells. Hence, the delivery obligation cannot exceed the amount of gas which Tenneco Oil is able to *produce* from existing wells.[4]

[3] Subject to the lease operations reservation, which is Section 5(d) and (f).

[4] Subject to the lease operations reservation, which is Article II, Section 1. Hereinafter, all descriptions of Tenneco Oil's delivery obligation include the lease operations reservation even if not specifically mentioned.

Thus under both types of standard contract, *the delivery obligation is related to production.* Under delivery capacity contracts, the express obligation is equal to the amount actually produced. Under the reserve ratio contracts, the obligation is dependent upon the amount of production which Tenneco Oil is able to develop and maintain from existing wells. Thus the ultimate question with respect to delivery capacity contracts is what quantity is Tenneco Oil obligated to produce. And the ultimate question with respect to reserve ratio contracts is what is the standard for determining the quantity of production which Tenneco Oil is able to maintain from existing wells. The answer to both questions is found in the provision, contained in all standard Tenneco Oil contracts, which reserves to Tenneco Oil the right to operate its property free from Buyer's control and in Tenneco Oil's sole discretion.

Section 5(a) of the delivery capacity contract (Exhibit A) provides as follows:

> "Seller [Tenneco Oil] reserves the following prior rights with sufficient gas to satisfy such rights:
>
> > (a) To operate its property free from any control by Buyer in such a manner as Seller, in its sole discretion, may deem advisable. . . ."

In view of this clause, Tenneco Oil's obligation to produce, by which its obligation to deliver under delivery capacity contracts is measured, is to produce that amount which Tenneco Oil in its sole discretion produces. Of course, Tenneco Oil owes a duty to its lessor to produce the lease as a prudent operator.

The corresponding clause in the reserve ratio contract (Exhibit B) is Section 2 of Article II:

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> ". . . the control and operation of Seller's [Tenneco Oil's] lands and leaseholds producing gas to be sold to Buyer hereunder shall remain the exclusive right of Seller. . . ."

The deliverability which Tenneco Oil is able to develop and maintain from the existing wells, which under reserve ratio contracts establishes Tenneco Oil's delivery obligation, is, of course, dependent upon the decisions Tenneco Oil makes in the operation of the dedicated properties. And, again, since those decisions are the exclusive right of Tenneco Oil, the amount actually produced as a result of those decisions controls the delivery obligation.

While the delivery obligation in all standard Tenneco Oil contracts is measured by the amount of gas which Tenneco Oil produces as a result of its operating decisions, Order 539 and Section 2.83 of the Commission's General Policy and Interpretations give some indication that the Commission views a producer's delivery obligation as coterminus with the purchaser's take or pay obligation. As stated above, the purchaser's take or pay obligation is separate and distinct from the delivery obligation. And, in fact, if the take or pay obligation is construed to be a delivery obligation, the result is a delivery obligation *lower* than the true obligation. This result is not surprising since the purpose of the take or pay obligation is simply to insure that the purchaser takes or pays for at least a *fraction* of the gas which the producer is obligated to have available for delivery. As a result, the purchaser's take or pay obligation will always be less than the producer's delivery obligation.

Both types of standard producer contract bear this out. Under the delivery capacity contract (Exhibit A), the take or pay obligation is equal to 90% of delivery capacity. Section 3(a). And, as discussed above, while delivery capacity is initially determined by test, if the amount actually delivered is less than the delivery capacity established by test, then the delivery capacity is the amount actually delivered. Section 3(g). As a result, the take or pay obligation cannot exceed 90% of the amount actually delivered. Thus, if the take or pay obligation were transformed into a delivery obligation, then the delivery obligation would be 90% of the amount actually delivered, an obviously absurd result.

Under the reserve ratio contract (Exhibit B), the take or pay obligation is initially fixed by the reserves to production ratio set forth in Section 1 of Article IV. As discussed above, however, if Tenneco Oil cannot develop and maintain a deliverability of 125% of the amount established

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by the reserves to production ratio, then the take or pay obligation is reduced to 80% of the amount that can be maintained. Article IV, Section 3. Thus if the take or pay obligation under this contract is transformed into a delivery obligation, then Tenneco Oil is obligated to deliver only 80% of the amount it can actually deliver. The purchaser would likely take exception to this construction of the contract.

IV.

Imposition of A Delivery Obligation Beyond the Contractual Obligation Be Both Unlawful And Unreasonable.

If the Commission construes Section 2.83(d) to impose a delivery obligation other than that undertaken in the contracts, or if the Commission contemplates promulgating such a certificate condition in this rulemaking, then the Commission will be acting outside of its authority and contrary to the public interest.

A. The Commission Lacks Jurisdiction To Impose A Delivery Condition Greater Than The Contractual Obligation.

Section 1(b) of the Natural Gas Act provides that the Act "shall not apply to . . . the production . . . of natural gas." This exemption has been construed to include "the physical activities, processes, and facilities of production. . . ." *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392, 402 (1965). Section 7(c) of the Act precludes the sale of gas in interstate commerce for resale

without Commission authorization, and Section 7(e) provides for the issuance of certificates of public convenience and necessity for such sales.

The amount of gas which can be delivered under a certificate inevitably is dependent upon the amount which is produced. Consequently, the amount that will be delivered is controlled by the management decisions made by the producer with respect to "the physical activities, processes, and facilities of production. . . ." Insofar as delivery conditions are concerned, there therefore appears on the surface to be a conflict between the Commission's authority under Section 7(e) to impose certificate conditions and the Commission's lack of authority under Section 1(b) over production matters. When the two sections are read together as they must be, however, there is no conflict and the Commission's lack of authority to impose delivery obligations becomes clear.

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The identical issue of the Commission's authority under Section 7(e) to condition a certificate with regard to matters explicitly placed outside the Commission's jurisdiction by another section of the Act was considered in *Central West Utility Company* v. *FPC*, 247 F.2d 306 (3rd Cir. 1957). In that case, a pipeline sought authority to enlarge service to some of its customers and to construct the facilities necessary to render the enlarged service. Central West, a customer of the pipeline, was served by the facilities that the pipeline did not propose to enlarge and thus the pipeline had denied Central West's request for enlarged service. Central West asserted that unless the certificate authorizing construction of the expanded facilities to other customers was conditioned to also require expanded facilities to service *Central West*, rendition of the service proposed by the pipeline would unduly discriminate against Central West in violation of Section 4(b) of the Act.

The Commission was well aware of its general authority to condition certificates under Section 7(e). But the

Commission also recognized its lack of authority as a result of Section 7(a) of the Act to compel the enlargement of transportation facilities. The Commission, quoting from *Panhandle Eastern Pipe Line Co.* v. *FPC*, 204 F.2d 675, 680 (3rd Cir. 1953), concluded:

> "In the light of Section 7(a) we are compelled to conclude that Congress meant to leave the question whether to employ additional capital in the enlargement of its pipeline facilities to the unfettered judgment of the stockholders and directors of each natural-gas company involved. *Panhandle Eastern Pipe Line Co., et al.*, Docket Nos. G-1705 *et al.*, 15 FPC 46, 58 (1956).

The Commission therefore determined that the specific prohibition of Section 7(a) precluded imposition of a certificate condition in derogation of that prohibition and held that it had no authority to impose the condition sought by Central West.

The Court affirmed, once again embracing the language quoted above upon which the Commission had relied. The court held that the Commission has no authority under Section 7(e) to impose a condition which would substitute the judgment of the Commission for the judgment of the regulated company in an area in which discretion has been reserved to the company.

The relationship between Section 7(e) and Section 1(b) is no different. Indeed, if the Commission were to do indirectly through Section 7(e) what it is prohibited by

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Section 1(b) from doing, not only would the Commission be intruding upon the judgment of producers in an area Congress has determined the Commission should *not* intrude, but furthermore the Commission would be intruding upon the judgment of the administrative bodies that Congress *has* deemed to be the appropriate governmental entities to deal with production matters. For Section 1(b) was the result of Congress' awareness that the regulation of production activities was a matter better left to other regulatory bodies. One of the basic purposes of Section 1(b) was to reserve to the states the power to regulate production activities as to non-federal lands within state boundaries since such activities were deemed to be a matter of local concern. *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944). The states have exercised this authority and have established regulatory bodies which have the expertise to deal with matters involving rate of production, such as production allowables. E.g., TEX.REV.CIV.STAT.ANN. Art. 6049c (1962).

Just as significantly, when production became a matter of Federal concern with the exploration and development to offshore Federal domain acreage, Congress placed the regulation of offshore production in the hands of the Department of Interior. Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331-1343.[5] Thus not only has Congress expressly precluded this Commission from regulation of production activities, it has also expressly determined that Interior is the federal administrative body with the expertise required to effectively regulate offshore production. Interior has placed this responsibility in the hands of the United States Geological Survey (USGS) and has adopted regulations which cover in detail every aspect of production from Offshore leases. 30 C.F.R. §§ 250.1, *et seq.* Those regulations provide, in essence, that the operator of an offshore lease must conduct operations as a prudent operator. 30 C.F.R. § 250.33.

Thus, there is no regulatory gap which the Commission must fill. To the contrary, failure to observe the production exemption would destroy the precise regulatory boundaries established by Congress. The Commission's lack of authority to impose a delivery condition other than the contractual obligation could not be clearer.

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[5] Production from federal lands onshore is covered by the Federal Mineral Leasing Act, 30 U.S.C. §§ 181, *et seq.*

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B. The Public Interest.

Even if the Commission did have the authority to impose a delivery condition beyond the obligation contained in Tenneco Oil's contracts, the imposition of such a condition would be contrary to the public interest. While Tenneco Oil, as a result of Order No. 539-A, feels that the Commission has made clear that it does not intend to impose a type of warranty condition, we do feel constrained to point out that such an arbitrary condition could only produce arbitrary and unreasonable results contrary to the public interest. A warranty condition does not take account of the practical restraints associated with the production of gas which result from factors such as the physical characteristics of the reservoirs and the wells. These same factors are the very ones Tenneco Oil considers in applying its expertise to operational decisions. A warranty condition would, therefore, preclude Tenneco Oil from acting as a prudent operator, a result most certainly not in the public interest.

Furthermore, imposition of a delivery condition under which the Commission would usurp Tenneco Oil's right to make the necessary operating decisions would equally disserve the public interest. Tenneco Oil is in the business of producing gas and has developed considerable expertise in that area. Not surprisingly in view of Section 1(b) of the Act, this Commission has never undertaken to regulate production activities. As a result, while the Commission has developed expertise in those areas over which it has jurisdiction, it has certainly not developed expertise in the area of production operations. The substitution of the judgment of a non-expert for that of an expert can only be contrary to the public interest.

Furthermore, even if the Commission had the expertise to make an informed judgment in this area, elicitation of data sufficient to allow the Commission to make that judgment would impose an enormous data submission burden on producers and an even more enormous regulatory burden on the Commission. Since the USGS is already staffed to perform these precise functions and is dicharging its responsibilities, a duplication of this undertaking by this Commission would not only be beyond the Commission's authority, but would amount to an extraordinary waste of resources. To undertake, without the requisite expertise, an enormous regulatory burden which is already being performed by an agency which does have that expertise would be unreasonable.

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V.

The Section 2.83(d) Condition

Section 2.83(d) purports to impose a delivery condition in every producer certificate issued by the Commission. Since the Commission has authority to impose such a condition, Section 2.83(d) must be deleted from the Commission's regulations.

Even if the Commission did have the authority to impose delivery conditions, Section 2.83(d) is unnecessary, misleading and confusing. Its reference to reserve determinations is apparently based on the reserve determinations contemplated for take or pay purposes under reserve ratio contracts. Of course, delivery capacity contracts do not even provide for such reserve determinations, and thus application of the Section 2.83(d) condition to those contracts is an exercise in futility.

In addition, Section 2.83(d), as construed in Order 539-A, fails to give effect to the lease operations reservation. That reservation is nothing more than the purchaser's recognition of the prior obligations of Tenneco Oil to its lessors and of the need of Tenneco Oil to use some of the gas in order to produce the leases in the most efficient manner. Surely, the Commission does not intend to force Tenneco Oil to violate its precedent lease obligations and to refrain from producing the leases in the most efficient manner. The interpretation given 2.83(d) in Order 539-A would lead to this result.

But other than the Commission's lack of authority to impose a delivery condition, the most fundamental problems with Section 2.83(d) is that it purports to deal with the delivery obligation, but provides for submission of data concerning the take or pay obligation. Section 2.83(d) is therefore not only confusing and misleading, but as written it serves no purpose. Section 2.83(d) should and must be eliminated.

Furthermore, if the Commission does have the authority to impose a delivery condition, there is nonetheless no need to require submission of data as contemplated by Section 2.83(d). As stated earlier, Tenneco Oil's onshore production operations are closely regulated by the states. See. e.g., TEX.REV.CIV.STAT.ANN. Art. 6049c (1962). And Tenneco Oil's offshore operations are subject to the regulation of the Department of Interior through the USGS. 43 U.S.C. §§ 1331, *et seq.*; 30 C.F.R. § 250.1, *et seq.* Every

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piece of data that could conceivably bear on the delivery of gas from offshore Federal domain leases must be filed with the USGS. See 30 C.F.R. §§ 250.34, 250.36, 250.38, 250.39, 250.40, 250.44, 250.51, 250.91, and 250.93. Thus, for example, Section 250.93 requires a monthly report disclosing ". . . all operations conducted on each well during each month. . . ." In addition to the number of days and the quantity of gas each well produced, the monthly report must also show:

> ". . . the date and reason for every shutdown . . . the dates and results of any tests such as production . . . and any other noteworthy information on operations not specifically provided for in the form."

Should the Commission determine it has the authority and deem it necessary to join Tenneco Oil's lessors, the state regulatory agencies, and the USGS in monitoring Tenneco Oil's production operations, more than sufficient data is already available from other regulatory agencies. The imposition of an additional reporting burden would

therefore be not only unnecessary, but totally unreasonable.

VI.

Summary

Tenneco Oil's position with respect to Order 539 and Section 2.83(d) can be summarized by response to the specific questions posed on page 11 of Order 539-A.

1. The take or pay provision most assuredly is not, and is not considered by the parties to be, a delivery obligation on the part of the producer.

2. The delivery obligation under all standard Tenneco Oil contracts is governed by the provisions which (1) require Tenneco Oil to deliver 100% of the gas actually produced from existing wells, subject to the lease operations reservation and (2) reserve to Tenneco Oil the right to make, in its sole discretion, the necessary operating decisions. Tenneco Oil owes a duty to its lessor to make those decisions as a prudent operator.

3. Tenneco Oil is not required under any of its standard contracts to deliver a specified volume of deliveries over a set period of time. To the contrary, Tenneco Oil's delivery obligation is as described in response to question number two.

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4. The Commission cannot and should not impose a delivery obligation which in any way usurps the producer's right, in its sole discretion, to make the necessary prudent operating decisions.

5. While Tenneco Oil has serious doubts as to the Commission's authority to require a producer to enter into any specified type of contract, Tenneco Oil firmly believes that the use of a standard delivery provision would in any event be undesirable and unnecessary insofar as Tenneco Oil is concerned. Such a form is unnecessary because Tenneco Oil's contracts already contain clear delivery obligation provisions. Thus, all that is necessary in order to eliminate the confusion that exists as to de-

livery obligations is a statement by the Commission in this docket which reflects the true nature of the contractual obligation.

A standard form provision would be undesirable because, while not achieving anything not already achieved by the clauses which are currently contained in the contracts, it would limit the parties' flexibility to tailor each individual contract to meet the peculiar circumstances attendant thereto.

6. The reporting requirements of Section 2.83(d) will not in any way furnish useful data. Section 2.83(d) requires submission of data not contemplated under some contracts, disregards the express lease operations reservation which the Commission has no authority to override, and generally is based on a contract provision (take or pay) which does not set forth the delivery obligation. Section 2.83 should therefore be totally eliminated.

7. There is absolutely no reason to require producers to submit production data to this Commission. Should the Commission nonetheless require submission of such data, that data that is of a confidential or proprietary nature must and should be kept confidential.

8. Both state regulatory bodies and the USGS have both the jurisdiction and the means to oversee production activities to a far greater extent than does this Commission. Indeed, the existence of such jurisdiction in the states and in the USGS underscores the Commission's lack of authority in this area. And since the USGS has the requisite jurisdiction and expertise to deal with production questions, and is staffed accordingly, the USGS is far more capable of overseeing production activities than the Commission. Indeed, an attempt by the Commission to extend its authority in this area would be a direct intrusion upon the authority

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vested by Congress in the USGS and reserved by Congress to the states.

VI.

Conclusion

For the foregoing reasons, Tenneco Oil respectfully requests that the Commission delete Section 2.83(d) from its General Policy and Interpretations. In addition, in view of the confusion and uncertainty created by Order No. 539, Tenneco Oil requests that the Commission expressly state the true delivery obligation under standard producer contracts. Further, Tenneco Oil submits that the Commission is without authority to impose a delivery obligation that invades the producer's right to make the necessary operating decisions.

Respectfully submitted,

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THE STATE OF TEXAS)
COUNTY OF HARRIS)

Stephen M. Hackerman, being first duly sworn, deposes and says: That he is lawyer for Tenneco Oil Company, that the statements contained in the foregoing Comments are true and correct to the best of his knowledge and belief, that he is authorized to file the same, and now does so upon his oath.

/s/ Stephen M. Hackerman
STEPHEN M. HACKERMAN

Subscribed and sworn to before me by the said Stephen M. Hackerman this 15th day of April, 1976, to certify which witness my hand and seal of office.

/s/ Linda S. Lee
LINDA S. LEE
Notary Public in and for
Harris County, Texas

• • • •

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect to Enforcement Of Deliverability And Rendition Of Natural Gas Services Under Certificated Arrangements	))))	Docket No. RM76-8

JOINT COMMENTS
OF
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April 19, 1976

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Service Under Certificated Arrangements	))))	Docket No. RM76-8

JOINT COMMENTS

OF

INDICATED PRODUCERS

The undersigned producers (Shell Oil Company, *et al.*, hereinafter designated "Producers"), in accordance with Ordering Paragraph (C) of Order No. 539-A in the captioned proceeding, file their comments, views and suggestions concerning the proposed rulemaking set forth in Order Nos. 539 and 539-A.

I. Statement of Position.

The undersigned Producers are opposed to the adoption of Section 2.83(d) as promulgated in Order No. 539, and amended in Order No. 539-A, and set forth on pages 12-14 of Order No. 539-A. The reasons for opposition are summarized as follows:

(1) The imposition of a certificate minimum delivery obligation is wrong as a matter of policy, because it requires the producer to justify, and the

Commission to monitor reductions in delivery quantities which occur as the natural consequence of the depletion of a gas or oil field. The imposition of this enormous administrative burden will operate as a disincentive to engage in gas exploration in the future, and the expense of these proceedings will force many producers out of business. The administrative burden

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on the Commission will be enormous as the monitoring will be required in every gas or oil field in the United States, requiring a continuing proceeding for each field and each reservoir.

(2) Insofar as these certificate conditions attempt to override contract provisions relating to the use of gas with respect to lease development and operations, recycling, pressure maintenance, or other recovery operations, for use by lessors in accordance with lease agreements, or taken in kind by royalty owners, the result will be to reduce the ultimate recovery of hydrocarbons from the lease and to force the producer who is regulated by the Commission to violate his lease agreement with the lessor-royalty owner, thereby subjecting him to voluminous and onerous litigation.

(3) The imposition of a certificate condition proposed in Section 2.83(d) is not required by the public convenience and necessity, and has its inception in unfounded, unjustified, and unproven charges that producers are wrongfully withholding gas reserves from production in violation of their

contracts. Such charges are untrue, have been frequently disproved by Commission investigations.

(4) If, in implementing this certificate condition, the Commission attempts to require the producer to make additional capital expenditures to avoid violating the certificate condition then such condition would divert capital funds which could otherwise be employed in exploring for new natural gas, into ventures which

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are less productive and would lead to higher overall costs for gas, which would have to be borne by the ultimate consumer. In so doing, the Commission would be assuming the management function of the producer, and will be attempting to control the production of natural gas, a function which is beyond its jurisdiction. In attempting to invade the right of the producer to utilize his gas production for pressure maintenance or re-cycling, the Commission is involving itself in the production of oil, a matter over which it has no jurisdiction.

(5) The entire thrust of the delivery condition is to require depletion of existing gas reserves as rapidly as possible, a proposition which has yet to be proved to be in the interest of the residential and small commercial consumer, which has been given priority in all of the Commission's pipeline curtailment proceedings. Acceleration of the depletion of reservoirs will allow lower priority users to continue their use of natural gas at far below

its market value for a short period of time, and will deprive the residential and small commercial user of this gas which could be made available to him over the longer term.

(6) The imposition of the certificate condition proposed as Section 2.83(d) is unlawful, because it attempts to impose Commission jurisdiction over the production of natural gas, which is specifically excluded from its jurisdiction under Section 1(b) of the Natural Gas Act. If the intent of this provision is to require producers to make additional capital expenditures to avoid violation of this provision when a reservoir depletes to the point when it is not capable of continuing production at the minimum delivery level,

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then the Commission has exceeded its jurisdiction as provided in Section 7(a) of the Natural Gas Act.

(7) Action by the Commission to enforce a "certificated minimum daily delivery obligation" may also require the producer to violate state law, or the rules and regulations of state conservation agencies in order to comply with the Commission's requirements. On federal lands, production operations are regulated by the United States Geological Survey, whose regulations may conflict with the requirements of the Commission under this certificate condition. The requirements of the Commission under this certificate condition may also force the producer to violate the terms of his oil and

gas lease, with a resulting financial liability to his lessor, or under some circumstances, the loss of the

Understanding a contract for the sale and purchase of natural gas requires an understanding of the business of exploring for and producing oil and gas. There are many property rights and contractual obligations already vested and established as to an oil and gas property before any gas sales contract is executed. Consequently, the gas producer cannot agree to terms and provisions in a gas sales contract, or in a certificate issued by the Federal Power Commission, which would require the producer to infringe upon the property rights of others or to violate obligations owed to others.

Ordinarily the gas producer does not own the land from which gas is to be produced. The producer has obtained the right to explore for and produce oil and gas from the land by acquiring an oil and gas lease from the landowner. Whether the landowner is a private person or a public entity, the oil and gas lease will reserve to the landowner-lessor certain rights and will create in favor of the lessor certain duties and obligations owed by the lessee. Among other things, the lessor under an oil and gas lease will have the

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right to receive a royalty on all oil and gas produced, and that royalty may be either a payment of money or a share of the oil and gas. The duties owed by the lessee to the lessor under the lease will include not only those expressed in the lease, but also those arising from implied covenants. The courts have developed over the

years a doctrine of implied covenants by the lessee, which are basic to the nature and subject matter of the lease. The lessee must operate the leased property efficiently, using such methods as are recognized in the industry to recover the maximum quantity of oil and gas. The Lessee may not shut-in a well capable of producing oil or gas in paying quantities if there is a market for the product, and the lessee has an affirmative duty to make diligent efforts to find a market for the product. Should the lessee voluntarily reduce or accelerate the oil and gas production from a property from that level of production which will achieve the greatest ultimate recovery, the lessee may be liable to the lessor for breach of the duty to operate diligently and efficiently.

For example, oil and gas leases granted by the United States covering submerged lands of the outer Continental Shelf provide in Section 3(c)(1) that the lessee has the obligation "[t]o diligently drill and produce such wells as are necessary to protect the Lessor from loss by reason of production on other properties or, in lieu thereof, with the consent of the Supervisor to pay a sum determined by the Supervisor as adequate to compensate the Lessor for failure to drill and produce any such well."

The gas producer-lessee when negotiating and executing a gas sales contract must give due consideration to the rights of the lessor and must retain the freedom to satisfy the duties imposed under the oil and gas lease. The gas producer cannot undertake an obligation to the gas purchaser which would inhibit performance by the producer of prior and superior obligations owed to the

lessor. The gas producer cannot undertake to deliver all of the gas produced from a

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property since the lessor may have a right (as does the United States in all leases covering the Federal Domain) to take a share of the gas produced as royalty. Further, the producer must reserve such quantities of gas as are needed for the proper and efficient operation of the property, including any gas that may be required for cycling and pressure maintenance in the reservoir. The gas producer cannot agree to produce any certain quantity of gas on a daily or monthly basis since to do so would prevent the producer exercising the prudence and judgment which he is obligated to employe in performing duties owed to the lessor.

The obligation which a gas producer undertakes in the usual gas sales contract is to deliver to the purchaser all the gas which is produced from a certain property less such quantities of gas as may be required to satisfy the rights of the lessor and to permit the producer to operate the property in accordance with the covenants of the lease. The producer ordinarily does not undertake any obligation to produce a daily quantity of gas or a certain quantity of gas during the term of the contract.

In the usual gas sales contract, terms such as "daily contract quantity" and "deliverability" or "delivery capacity" are used to define the obligation not of the producer, but of the purchaser, the obligation to receive and take gas which may be produced. The purchaser

is often required to purchase and take or to pay for if available and not taken a certain quantity of gas, which may be defined as the daily contract quantity or a percentage of the daily contract quantity accumulated over a period of time. The daily contract quantity will be determined on the basis of deliverability or delivery capacity, and the producer may be required from time to time to demonstrate deliverability or the delivery capacity, but such demonstration is only for the purpose of establishing the purchaser's obligation to take gas, not for the purpose of fixing an obligation upon the seller.

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All of the foregoing points were argued at some length in the Motion for Oral Argument filed by Producers on December 30, 1975. In response to these arguments, the Commission stated that Order No. 539 was not intended to impose a specific warranty obligation if none were provided for in the contract, and that it was the Commission's intention only to enforce contract and certificate obligations. The Commission further announced its intention not to violate the "production and gathering" exemption of Section 1(b) of the Natural Gas Act or to interfere with the jurisdiction of state or federal agencies in that area. The Commission further stated it was not its intention to impose upon the producers any obligations or duties other than those imposed in their contracts and certificates (Order No. 539-A, p. 6).

While this discussion, considered alone, may be reassuring, the language in Section 2.83(d) still requires a "certificated minimum daily delivery obligation", and provides that that obligation may be changed from that

provided in the seller's contract, and that the certificate obligation shall override contractual reservations to the contrary (p. 13).

Unfortunately, the Commission apparently has failed to grasp the gravamen of our objections—that is, that, having negotiated its contract with the pipeline to establish the rights and obligations of each, the producer is still faced with the prospect of the addition by the Commission of something which it conceives to be a proper "certificated minimum daily delivery obligation". Even as revised, Section 2.83(d) is still subject to the obligations set forth in our Motion for Oral Argument and reiterated above. We therefore incorporate the Motion for Oral Argument into these comments by reference.

The further argument contained herein will be directed to the specific questions asked on page 11 of Order No. 539-A, and an attempt to further clarify the ambiguities and issues referred to on pages 10 and 11 of Order No. 539-A.

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II. Argument.

A. The Proper Interpretation Of The Daily Contract Quantity Provision Or "Take-Or-Pay" Provision In The Typical Gas Sales Contract.

As set out in the Application for Rehearing and Motion for Reconsideration filed by a number of the undersigned Producers[1], the delivery provisions in the typical producer gas sales contract do not obligate the producer

1. Shell Oil Company, *et al.*, Application for Rehearing dated November 11, 1975.

to deliver any specific quantity of gas. The take-or-pay provision which is based on the daily contract quantity (averaged annually) is a requirement on the pipeline company to take a minimum quantity of gas or to pay for that quantity if available and not taken and imposes no obligation on the producer to deliver a specific quantity of gas. Throughout the history of the industry, the producer has always insisted on as rapid a take of the gas from the producing fields as prudent operating conditions would permit in order to accelerate the receipt of revenue. The pipeline on the other hand has always negotiated for a longer period of delivery, in order to protect its reserve position and to allow a long enough period for depletion of the reserves to permit amortization of the cost of constructing the pipeline facilities to connect the reserves. As the gas shortage has deepened, the pipelines for the first time in their history are facing a situation where all of their existing facilities cannot be utilized. Therefore, the historical pipeline resistence to full deliveries from the fields has been reduced or eliminated. The consequence has been that most fields are producing at the full capacity of the fields to produce under prudent operating conditions. But this productive capacity is a limitation on the obligation of the producer to deliver. Furthermore, the typical gas sales contract retains full control over all production operations in the producer-seller.

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In the application of ordinary rules of contract construction, the Commission has no specific expertise, and the contracts are construed according to normal judicial precedent, see *Texas Gas Transmission Corp. v. Shell*

Oil Co., 363 U.S. 263, 268-69 (1960); *Skelly Oil Co. v. F.P.C.*, Case Nos. 74-1675, *et at.*, ____ F.2d ____ (10th Cir. 1976). The Commission has no power to interpret the contract in a way other than that intended by the parties as shown by the language of the contracts themselves. The answer to the first question on page 11 of Order No. 539-A is "No".

The second question on page 11 asked what provision in the contract normally does govern delivery. The answer is, is that there is no single provision. The contract must be construed as a whole. While provisions of contracts obviously vary, the usual provision for delivery is for the producer to deliver the natural gas which is commercially producible, in accordance with the terms of the lease, from the specific acreage or reservoirs committed to the contract. The timing of that delivery is usually determined as a percentage of the reserves or delivery capacity, but is always subject to the physical ability of the existing wells to produce. The decision whether additional development wells should be drilled is reserved to the producer, in conformance with his obligation to the lessor. The answer to the third question is "No", except for unusual warranty contracts.

B. The Commission Has No Authority To Impose The Condition Set Out In Section 2.83(d).

The next series of questions asked by the Commission on page 11 of Order No. 539-A, beginning with question 4, deal with the proposed certificate condition for minimum delivery requirements to be applied to certificates issued in the future.[2] The Commission has

2. The provision is retroactive to the effective date of Order No. 539, see Order No. 539-A, p. 11.

the power to issue certificates subject to reasonable terms and conditions, provided that those conditions are not outside of its jurisdiction, and do not represent attempts to do indirectly what the Commission is prohibited from doing directly, see *Sunray Mid-Continent Oil Co. v. F.P.C.*, 364 U.S. 137, at 152 (1960). The supervision of a certificate minimum delivery obligation inevitably involves the Commission in the regulation of production operations, in violation of the exclusion of jurisdiction contained in Section 1(b) of the Natural Gas Act.

Whether the Commission has the authority to impose a particular type of condition under Section 7(e) is necessarily dependent upon whether the Commission has the authority to enforce that condition. The enforcement of any delivery condition would inevitably lead to the Commission requiring producers to expend funds. Yet the Commission has no such authority.

Central West Utility Co. v. F.P.C., 247 F.2d 306 (3rd Cir. 1975) concerned a distribution company's request for the imposition of a condition by the Commission which, if granted, would necessitate the involuntary investment of a natural gas pipeline company's capital. In that case the Court said, in quoting from the Commission's Order:

> ". . . if Congress had intended that we have a power of such extent and possibly far-reaching impact, the grant of such authority would be confirmed by something more specific than the general and rather standardized 'conditions' provision of Section 7(e)." (247 F.2d at 311).

The Court held there was no irreconcilable conflict between the prohibition of Subsection 7(a) against compulsory enlargement of transportation facilities and the grant by Subsection 7(e) of the power to attach such reasonable conditions to the issuance of a certificate

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as the public convenience and necessity may require. All that was needed in the Court's judgment was to construe "what is a reasonable condition under subsection (e) in light of what is prohibited by subsection 7(a)" (247 F. 2d at 313). We submit that what is a reasonable condition under Subsection 7(e) must be construed in light of the express exemption in Subsection 1(b) of the production and gathering of gas.

Order No. 539 creates an obligation with respect to the delivery of gas by producers to pipeline customers at the wellhead. This is clear whether the Commission describes it as a "certificated minimum daily delivery obligation" or a "certificated delivery obligation". The effect is to impose on the producer the obligation to deliver gas at specific rates to the customer by regulating the rate of the production from his wells and, if this is inadequate, to drill new wells. Thus, such conditions imposed under Subsection 7(e) run squarely into conflict with the exemption in Subsection 1(b) of the Act. Any certificate conditions (such as "certificated minimum daily delivery obligation" or "certificated delivery obligation") imposed by the Commission under Subsection 7(e) that conflict with the exemption provided in Subsection 1(b) would be unreasonable conditions under the analysis in the *Central West Utility Company* decision.

The Commission's lack of authority in this area does not create any regulatory gap. The regulation of production activities on federal lands has been specifically delegated to the Department of the Interior. Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331, *et seq.*, Federal Mineral Leasing Act, 30 U.S.C. §§ 181, *et seq.*, and the United States Geological Survey, to whom Interior has delegated this responsibility, has actively enforced this mandate, 30 C.F.R. §§ 2501, *et seq*.

Similarly, the regulation of production operations within state boundaries, other than federal lands, which was reserved to the states under Section 1(b), has been actively undertaken by the states. See

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Texas Review Civil Statutes Annotated, Article 6049C, *et seq.;* 52 Oklahoma Statutes (1961) 274; New Mexico Statutes Annotated (1953); 65-3-13, *et seq.;* Kansas Statutes Annotated 55-703, *et seq.;* West's Louisiana Statutes Annotated R.S. 30:4, *et seq*. As a result, any intrusion into production activities by the Federal Power Commission would not only violate Section 1(b) of the Act, but would also violate the mandate of Congress to Interior and to the States.

The fact that the proposed action or inaction, by the producer may result in reduced deliveries without approval of the Commission does not operate to give the Commission jurisdiction over production operations. This specific question was considered by the United States Supreme Court in F.P.C. v. Panhandle Eastern Pipe Line *Co.*, 337 U.S. 498, 508-10 (1949). The language of the Supreme Court is in point:

"To accept these arguments springing from power to allow interstate service, fix rates, and control abandonment would establish wide control by the Federal Power Commission over the production and gathering of gas. It would invite expansion of power into other phases of the forbidden area. (n. omitted) It would be an assumption of powers specifically denied the Commission by the words of the Act as explained in the report and on the floor of both Houses of Congress. (n. omitted) The legislative history of this Act is replete with evidence of the care taken by Congress to keep the power over the production and gathering of gas within the states. (n. omitted) This probably occurred because the state legislatures, in the interests of conservation, had delegated broad and elaborate power to their regulatory bodies over all aspects of producing gas. (n. omitted) The Natural Gas Act was designed to supplement state power and to produce a harmonious and

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comprehensive regulation of the industry. (n. omitted) Neither state nor federal regulatory body was to encroach upon the jurisdiction of the other. (n. omitted) Congress enacted this Act after full consideration of the problems of production and distribution. It considered the state interests as well as the national interest. It has both producers and consumers in mind. Legislative adjustments were made to reconcile the conflicting views." (337 U.S. 509-13)

As noted by the Supreme Court, Congress was aware of the action being taken by state regulatory agencies controlling the production and gathering of natural gas, and specifically reserved the control of that function to those agencies, and not to this Commission. If a producer is required by this Commission to meet a certificated minimum delivery obligation, which can only be met by prematurely producing the gas cap, thereby reducing the oil recovery, or violating proration orders limiting the amount of oil production and thereby limiting the amount of casinghead gas, the producer will be caught in a position where he cannot avoid violating either state or federal law.

The proscription against regulation of production operations, and interference with state jurisdiction over these operations is paramount over this Commission's authority to deny abandonment under Section 7(b) or its authority to impose conditions under Section 7(e), see *F.P.C. v. Panhandle Eastern, supra.*

The Commission contends, but cites no authority, for the proposition that all of the provisions of the contract are incorporated into the certificate, even though the certificate contains no language to that effect (Order No. 539-A, p. 2). This position is currently being contested in two cases now pending before the United States Court of Appeals for the Fifth Circuit, *Shell Oil Co. v. F.P.C.*, Case No. 75-3593 and *Mitchell Energy Corp. v. F.P.C.*, Case No. 75-3110. As that Court's decision will probably

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resolve this question, we will not argue it at length here. We note that as we read the cases, the Commission merely

certificates, or authorizes, the sale as being in the public convenience and necessity, subject to whatever conditions it (lawfully) imposes. This authorization for the commencement of "service" (see *Sunray, supra,* 364 U.S. 137, 152) is completely independent of the contractual relationship of the parties, which remains the same as it was before the Natural Gas Act was passed, see *United Gas Pipe Line Co. v. Memphis L., G. & W. Div.*, 358 U.S. 103, 109-10 (1985). Therefore, the Commission has no power to *make* the contract between the parties, or to require commitment of additional reserves, or to provide a "uniform contract form" (Order No. 539-A, Question No. 5, p. 11).

As the Supreme Court said in *Mobile-Memphis,* this is the principal distinction between the Natural Gas Act and the Interstate Commerce Act, where the Interstate Commerce Commission prescribes tariffs for the parties, see *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332, at 338 (1955). In all of the area and national rate decisions up to and including Opinion No. 749 in Docket No. R-478, the Commission has noted that because of contract limitations the producers would be unable to realize the revenues which they should receive under the decision if all of the rates were permitted to escalate to the ceiling price. It is only where the Commission finds that the rate provided in the contract is so low as to adversely affect the public interest, impair the financial ability of the utility to continue service, or be unduly discriminatory, that the Commission can supersede the contract, see *F.P.C. v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956). It is because the Commission has only a *rate-reviewing,* not a *contract making* power that it

cannot impose delivery conditions, or uniform contract forms, or conditions requiring dedication of additional reserves.

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Order Nos. 539 and 539-A seem to imply, although it is never clearly stated, that the issuance of a certificate imposes some condition on the producer not to reduce deliveries below that set out in the initial billing statement or the initially-determined minimum contract quantity without Commission authorization. This theory apparently has its roots in the provisions of Section 7(b) of the Natural Gas Act, which prohibits the abandonment of facilities or "service rendered" without permission of the Commission. The careful reading of this provision and the Court decisions construing it will disclose that there is no requirement that the Commission take any action whatsoever upon a reduction of deliveries, particularly where the reduction of deliveries is occasioned by the normal depletion of the gas field. While Section 7(b) of the Act requires Commission approval for abandonment of a portion of the facilities, there is no requirement for Commission permission for a reduction in deliveries under a contract. On the contrary, that provision contemplates a continual reduction of service as a gas field is depleted. *Sunray Mid-Continent Oil Co. v. F.P.C.*, 364 U.S. 137 (1960), and *Sun Oil Co. v. F.P.C.*, 364 U.S. 170 (1960), both deal with an attempt to abandon service in order to make sales to a different purchaser. In fact, these two cases draw clear distinctions between the obligation to continue service and any contractual relationships between the parties, see *Sunray*

Mid-Continent, supra, 364 U.S. 137, 152-53. If Order Nos. 539 and 539-A are to be read as implying that the certificate incorporates all the provisions of the contract, even though the certificate contains no language expressly so doing, then these Orders are in conflict with prior Court decisions, see *United Gas Pipe Line Co. v. Memphis L., G. & W. Div.,* 358 U.S. 103 (1958); *Atlantic Refining Co. v. Public Service Commission of New York,* 360 U.S. 378 (1959); *Texaco Inc. v. F.P.C.,* 290 F.2d 149 (5th Cir. 1961).

The Commission raises the question of the best method of providing "the data necessary to enforce the policy stated in Order No. 539. Without debating the wisdom or propriety of that policy, we submit that the simplest and most effective method to do this is to

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modify the present Form No. 15 to indicate the pertinent rate schedule to which the reserves and production data reported thereon pertain. By making this simple addition to an existing form, the Commission can avoid contributing to the current proliferation of reporting forms yet still obtain the data it seeks, in accordance with current Commission policy.

Assuming *arguendo* that the Commission has the power to collect the reserve data required by Section 2.83(d) (we believe that if the basic requirement for a delivery condition is withdrawn as a matter of policy, or is declared by the Commission or the Courts to be outside the Commission's jurisdiction, the data request is rendered moot), then this data should be kept confidential

if the producer so requests. A similar question is pending in the Ninth Circuit in *Union Oil Co. of California, et al. v. F.P.C.,* Case Nos. 75-2891, *et al.,* and in the Fifth Circuit in *Pennzoil Co., et al. v. F.P.C.,* Case Nos. 75-3003, *et al.*

III. Conclusion.

WHEREFORE, the Producers submit that the Commission's findings after considering the comments and oral argument by the parties in this proceeding should be as follows:

(1) A typical contract provision[3] does not require delivery of minimum quantities of gas because of, *inter alia,* provisions which allow or require those quantities to be reduced in the event the productive capacity of the field through existing wells declines, or various other rights reserved to the producer are exercised.

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(2) Existing certificates do not require the delivery of specific quantities of gas, and no authority is required from the Commission to reduce delivery quantities where the reduction occurs by natural decline, or is permitted by any provision of the producer's contract short of total abandonment, in which event Commission approval is required under Section 7(b) of the Natural Gas Act.

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3. Excluding certain unusual contracts which stipulate delivery of specific minimum daily quantities.

(3) The Commission should not adopt the proposed Statement of Policy contained in Section 2.83(d) for the following reasons:

(a) Supervision of these certificate conditions would require supervision of production operations in violation of Section (1)(b) of the Natural Gas Act.

(b) Supervision of these certificate conditions would overlap and conflict with state conservation regulations and with the rules and regulations of the United States Geological Survey on federal lands.

(c) Supervision of this certificate condition would impose a massive administrative burden on the Commission and the industry, which is not warranted or justified by the public convenience and necessity.

(d) The only justification for imposing this certificate condition is the charge that the producers are unlawfully withholding gas from the market in violation of their contracts. Upon investigation by the Commission Staff in the *Transco* proceeding, it was concluded that such charges are unfounded and did

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not provide a valid reason for the imposition of this certificate condition.

(e) The imposition of the certificate condition would operate as an disincentive to gas producers, reducing gas exploration and development in the United States at the time when such exploration and development need to be encouraged to alleviate the natural gas shortage.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I was advised on the 11th day of November, 1975 by the Office of the Secretary of the Commission that no service was required on any person other than the Commission, and that filing with the Secretary would constitute compliance with the requirement of Section 1.17 of the Rules of Practice and Procedure.

Dated at Houston, Texas, this the 19th of April, 1976.

THOMAS G. JOHNSON
Thomas G. Johnson

Of Counsel for

Shell Oil Company

* * *

TRANSCRIPT OF ORAL ARGUMENT

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ORAL ARGUMENT OF THOMAS G. JOHNSON

SHELL OIL COMPANY

Mr. Johnson: First, I think the understanding of what producer and pipeline contracts contain with reference to delivery obligations depends on an understanding of some of the background and some of the legal and physical positions the producers find themselves in at the time they enter into a contract with a pipeline.

Starting at the beginning, the first legal obligation a producer incurs is his oil and gas lease with the landowner. That oil and gas lease has very definite obligations on the producers. The producer is given under that lease the sole right to make all decisions with reference to exploration and production on that lease. But that right carries with it certain obligations. And the primary consideration to the royalty owner, or the terminology is indicative of what I am to say, the payment to the landowner of his percentage of oil and gas as royalty.

Because that is the primary consideration going to the landowner the courts and the lease forms have circumscribed the lessee's right to explore, by a number of obligations, and in general form they are these:

The lessee has the right, the initial right to develop the property, and he has that obligation. He also has the obligation if he finds oil or gas to fully develop that

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oil or gas field.

He has the further obligation to protect that particular landowner's section of that oil and gas field against drainage from wells on neighboring property, and he has the further obligation to market the product he finds.

All these obligations are the subject of voluminous State Decisions. They are not absolute obligations. They are bound by rules of reason, what the State Courts have called the ordinary prudent operator rules, that is, the operator is confined not to a standard of perfection, but rather a standard which would define the actions of an ordinary prudent operator.

This term has received a great deal of refinement in State law.

Basically, the landowner has the right to file suit against the lessee, and if the lessee has not been diligent in developing the property or marketing the products, the landowner has the right to cancel his lease.

Now, that is a very strong remedy. The lessee loses not only the lease but all his equipment on the lease, and his full investment.

I assure you that lessees regard that obligation in a very serious way.

Commissioner Smith: Does anyone else have enforceable rights other than the lessor and the lessee, under that

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instrument?

Mr. Johnson: Under the oil and gas lease?

Mr. Smith, it is my opinion they do not. I think the rights and obligations are to the parties to the contract. I don't believe there is anyone else who can enforce those obligations.

This brings me to my second point, which is that—

Excuse me.

Commissioner Smith: For our purposes here, as far as searching for obligations which arise which would be enforceable by this Commission or by the Purchaser, we should just forget the oil and gas lease?

Mr. Johnson: The point I am trying to make, Commissioner Smith, is that I would say, first, in answer to the question, the Federal Power Commission has no jurisdiction to enforce the obligations of an oil and gas lease. That is my opinion.

The point I am trying to make is that whatever the Commission's jurisdiction may be, and I get to that, if I may, in an orderly way, the Producer has obligations to do things regardless of any action this Commission takes. That is the point I am trying to make at this stage.

These obligations exist before any sale ever occurs in interstate commerce.

Have I answered your question?

Commissioner Smith: Yes, sir.

Let me put it this way: If the lessor and lessee

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agreed, for whatever reasons, production from a given property was too rapid, does anyone else have anything to say about that under the lease instrument?

Mr. Johnson: With that qualification, no. I would note this: Landowners are individuals normally farmers, people who own the land, and they are anxious to get their money as quickly as they can.

The position almost uniformly of a royalty owner is "I want that production as fast as I can get it. I want the product marketed as fast as I can get it done."

The Courts have circumscribed that by a "rule of reason," because this inclination in the opinion of the lessee frequently leads to nonrecovery of some of the reserves in the ground.

So I would say the answer to your question is that no one other than the lessor has the right to enforce the obligations of an oil and gas lease.

If I may go forward, I will say we believe the next set of obligations of a lessee is circumscribed by the State Conservation Acts and in Federal leases by the regulations of the United States Geological Survey. On Federal lands the two come together, because the USGS regulations are set out in the lease itself, and the same party as operates the regulations has the rights of the lessor to enforce the lease.

In the case of Federal lands, the right of the Federal

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Government is more extensive than that of the landowner, because they have the right to enforce their obligations.

In that situation we have a broader authority than a private landowner would have.

But State Conservation laws are enacted to prevent waste of oil and gas. The drilling is very closely supervised, drilling permits are required, the rate of production is sometimes regulated, particularly if the rate of production is in connection with oil, for example production of a gas cap is frequently prohibited, because to do so would result in leaving quantities of liquid hydrocarbon in the ground. So there is a large area where the State Conservation Agencies have a large body of jurisdiction over the production operation.

I would like to focus on that. When we get later to the question of the jurisdiction of this Commission, this is one of the basic reasons why the Congress and the Courts have held that this Commission should not have control over the production activity or production operation. It is our opinion that the Certificate condition suggested here will have to result in that kind of interference and regulation.

I would like to develop first this point: In addition to these legal obligations the producer-lessee has, there are also physical requirements, or physical constraints, if you will, which face the lessee or producer at the time he enters

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the contract.

I prepared this chart over here, which attempts to illustrate an example of a single field. I will carry the example further later.

First let us think of it in terms of a single field which requires a new pipeline to be built to connect that field to an existing system.

The level green line there represents the pipeline capacity.

The curved line, the gray line, represents the productive capacity of the field.

The brown line represents the actual production from the field.

You can see that at the year Zero is the time I have assigned there for the Certificate Application. The field has already been discovered, certain reserves proved, Certificate Application filed, the Commission issues a Certificate, the pipeline begins construction, and at the point where the star is, the actual deliveries commence.

You can see at that point the constraint is not the productive capacity of the field. The constraint is the capacity of the pipeline. It makes sense, because it would not make much sense to build a new pipeline which was sized to take the maximum capacity of the field at the time of flush production, because you can see from that curve very quickly

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that line would have excess capacity.

The consumers would be paying for a lot of pipe and steel in the ground that were uneconomic to pay for.

Nonetheless, the important thing is the constraint at that time is the pipeline capacity, not the productive capacity of the field.

Then the field proceeds through further development and at the top of the curve, the field is fully developed.

The history of the field ultimately reaches the point that the field capacity can not longer exceed the capacity of the pipeline to take. From then on the limiting factor is no longer the pipeline capacity but productive capacity of the field, and that continues throughout the remaining life of the field.

The problem is today that if we translate our single example into terms of pipeline transmission companies, which are connected to many fields, in most of the fields which are now producing in the United States today—most of them were discovered and developed in the 1950s and early 1960s. During the late 1960s the pipelines were in the fortunate position of being by and large here (indicating). So there was excess productive capacity the pipelines could not take, and the pipelines found themselves in take-or-pay situations, building up large obligations to producers because they could not take the quantities of gas.

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But because of the fact—and I submit, although this is not the place for this argument—it was due in large part to the restrictive pricing policies of this Commission—but the fields being discovered were not sufficient to replace those fields which were being depleted.

So the problem today is that the pipelines find themselves in this position, where the limiting factor of delivery is not pipeline capacity, but the productive capacity of the fields.

When a new field is committed, this says the pipeline with excess capacity instead of being constructed like this, the pipeline capacity is here (indicating), so even in the situation of a new field, you have the situation that your production still may be limited by the productive capacity of the field, even initially, in many situations where pipelines are running with excess capacity.

So the problem is that when the limiting factor of delivery is the productive capacity of the field, then we have a highly uncertain situation.

All of our briefs and the testimony we filed in the NGLP case attempts to illustrate the uncertainties involved in trying to predict with any accuracy the manner in which a reservoir, gas reservoir, will produce.

We know it will not be stable. We know it will gradually decline, the rate of decline is frequently unpredictable. You

can guess at it, but very commonly unpredicted circumstances occur. Water may intrude, or the wells begin to produce sand, at a rate no one anticipated. The problem is, you just can not predict what that curve will be for any given gas field.

That brings us then to the contractual provisions we entered into with the pipelines, up to date and to the

Commission's question in Order 539-A, about what is the provision of a contract for delivery.

I think the answer is, the producers have a delivery obligation under their contracts, and that obligation is to deliver the gas from the field or reservoir committed to that contract.

But the rate of delivery is something else again. And the rate of delivery is circumscribed by several provisions, not just one.

The one the Commission, I think, initially focused on, although I think in—

Commissioner Watt: Are you talking about the obligation under what instrument?

Mr. Johnson: Contract between the gas producer and the pipeline company to sell gas in interstate commerce.

Commissioner Smith: You listed three resource agencies, the leasing instrument and the parties thereto, then the resource agency, which in some instances, particularly with

Federal lands, will be party to the lease instrument also.

Mr. Johnson: Yes, sir.

Commissioner Smith: Obligations imposed by the Resource Agency are, again, "prudent operator" as colored by whatever conservation objectives the resource agency seeks?

Mr. Johnson: I think that is correct, Mr. Smith—Commissioner Smith.

I think the terminology of the USGS Regulations is "due diligence," one of our favorite legal terms, meaning it depends on the circumstances of the individual case.

But it is a standard, and the only legal standard you could have under these circumstances, because the circumstances are different in each case.

To proceed with the contract obligations, the maximum and minimum take provisions were originally designed as simply "swing" provisions in the pipeline to allow the pipeline flexibility.

The minimum take provision was designed to cover the situation where the field has capacity greatly in excess of the capacity of the pipeline to take. The producer wanted assurance a minimum quantity of gas would be taken from the field all the time, because he had to pay the royalty owner each month, and he had a physical problem if he had to shut in the wells in the summer, and just produce them in the winter, as the pipelines would originally have liked; because

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this creates operating problems and sometimes when you shut in a well you can not bring it back. You may have severe operational problems, causing a well to have to be redrilled.

So the producer wanted the reservoir to have a minimum production over a period of time. And that is the so-called "take-or-pay clause."

That is really what the minimum provision was designed to cover, that first segment of the delivery.

There is another provision in practically all producer contracts today, and that there is another limiting factor, which is the capacity of the field to produce. So when you get into the second part of that production curve, that factor takes over. That is where we are today in most instances.

There is nothing wrong with this, that is what the parties contemplated all along.

So that is really what the delivery obligation is.

In answer to the Commission's third question, that is, "Do any of these problems provide for a specific volume of deliveries," the answer is "No, they can not, because no one knows what the volume will be, which is determined by what the field will produce at any given time."

I defy anyone to predict what a given field will produce fifteen or twenty years from now. You can make estimates, but those estimates will change.

That is the reason the contracts in effect have a sliding

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scale as far as delivery requirements are concerned.

If there are no questions about—

Well, let me say one more thing:

I detect from the orders that there is—from some of the comments filed—that some parties take the position the Commission's Certificate imposes additional obligation in terms of delivery, over the contract. We strongly

dispute that. We do not believe the Certificate issued by the Commission contains any conditions other than those spelled out in the Certificate.

The Commission has the power under Section 7(e) to impose proper certificate conditions, assuming it does not violate any of its other jurisdictional limitations, and assuming they are reasonable. But the Commission can not do that sub silencio without saying so. Because the parties—the producer has the right under CATCO and under the Sun Ray case, to make a decision when the Commission issues a Certificate containing conditions. The producer can decline it, and the courts have clearly upheld that right. That means the producer has the right to clearly know what those conditions are at the time or before he begins delivery.

We do not believe the Commission can retroactively or silently impose a condition that is not spelled out in the Certificate.

Now, there is also some difference of opinion as to

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whether or not the Certificate incorporates the provisions of the contract. A good argument can be made that it does.

I submit to you the best argument that was made that it does was made by Justice Harlan in his dissenting opinion in the Sun Oil case. But it was a dissenting opinion.

The majority in the Sun Ray and Sun Cases held that the producer is proscribed by two things—by Commission

Regulations under the Act, and by his contract. But they are not the same. If they had been the same, Sun Ray would have been decided the other way. Because the minority would have held when the contract terminated the Certificate terminated. But the majority said, "There is an obligation to serve."

What are the terms of that service?

We submit they are simply what the Commission can legally impose, and does, what they do impose in a certificate.

That brings us to the second question, which is really the critical question here today:

What is the Commission going to do in the future?

And the question is also whether or not you will still stay with Section 2.83(d).

Commissioner Smith: Mr. Johnson, do you state that if there are terms in the contract which might grow beyond the terms which would be the Commission's, within the Commission's power to require to be in there, the Commission would not be in an enforcement position for those contractual provisions

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if the pipeline did not meet them?

Mr. Johnson: Mr. Commissioner, I think there are cases, Texas Gas, Shell, other cases, holding the Commission's power over contracts—it has no peculiar expertise in this area, and that is really something we think is left to the courts.

We think a pipeline, if we violate our contract, can sue us in court.

We have a question, and it is my opinion, that the Commission is not the agency to enforce pipeline contracts. We think the pipeline should pursue its remedies in court.

Commissioner Smith: Will this be ultimately resolved in the warranty cases?

Mr. Johnson: One of the things pending before the Fifth Circuit is the scope of the Commission's Certificate. Depending on the opinion of the court, they may or may not resolve it.

It is possible to avoid that issue if the court wishes.

Commissioner Smith: Are you saying if the Commission has a producer contract which contains obligations voluntarily entered into by the producer we might be well beyond those the Commission could require the producer to assume, the Commission can not enforce that certificate which would encompass everything the parties have committed to do in the contract?

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Mr. Johnson: You are assuming what I believe is an incorrect statement of law, which is that the Certificate encompasses the contract.

I don't think it does. I think Sun Ray holds squarely to the contrary.

Commissioner Smith: That is what I want clear.

You are saying the obligations assumed by the contract are private obligations to be privately enforced and the Commission has no authority to insist that they be enforced?

Mr. Johnson: Yes. That is my opinion, sir.

Commissioner Smith: A unique contractual arrangement on the basis of which this Commission certified not only the contract of sale but also the expenditure of, say, moneys to build a pipeline system, that would remain a private matter between those parties?

Mr. Johnson: No. I think that is a different question.

Once a producer begins deliveries he can not stop deliveries. That is clear. The Commission has the power to prevent abandonment. And it is also clear that the Commission has jurisdiction over the rates to be charged.

It is also clear the Commission has the power to grant or deny the initial certificate.

Commissioner Smith: The Order incorporates as specifically as it can its language of the contract.

Mr. Johnson: I disagree, unless the Commission specifically

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says in the Certificate, all the provisions or specific portions of them are made conditions to that Certificate.

Commissioner Smith: It does, in the standard boilerplate certificate.

Mr. Johnson: I disagree.

Commissioner Smith: All Certificates issued, which have language designed to incorporate provisions of the contract, you did not agree that this makes the language of the contract part of the Certificate, and there it is within the power of the Commission to enforce the Certificate?

Mr. Johnson: I don't have in mind the language you refer to.

I think the normal language of the Certificates I have seen do not specifically incorporate all of the provisions of the contract in the Certificate. And I question whether that—whether they can do that in part.

In other words, for example, Commissioner Smith, the Commission makes it quite clear that if the term of the Certificate is to be limited to any specific time period, that has to be spelled out in the Certificate, itself. Because if it is not spelled out in the Certificate, itself, even though the contract terminates, the Certificate does not.

The Chairman: You mean not by reference? It could not be so by reference to the contract, in the Certificate?

You are saying specific provisions would have to be

incorporated in the Certificate, not by reference?

Mr. Johnson: Mr. Chairman, I think what I am trying to say is that the producer's obligations under contracts are one thing. They are clearly set out in the contract.

The Mobil-Memphis doctrine says "Producers can enter contracts, and those contracts are subject to review by the Commission, and the rates are subject to review, and the Certificate jurisdiction is there."

But the contract is a creature of the parties. That is what we believe the cases say. It is not something which becomes part of the Certificate.

What the Commission does when it issues a Certificate is to certificate the service to be performed.

And the scope of the service to be performed is, I think, a question that is a very difficult thing to read out of the Court Decisions.

It is our view that the Louisiana Power and Light case and the Michigan Power case hold that reduction of deliveries does not require authority from this Commission under 7(b).

And as we read 7(b), it specifically refers to the depletion of the field as one of the two rounds for abandonment.

If depletion is recognized as a ground for abandonment, full depletion, then we think partial depletion necessarily has to be authorized by this Commission, because nobody can

make a gas field produce more than it will produce—not the producer, or the Commission, or anybody.

We are really talking about whether this Commission should determine whether or not the producer properly

is operating and producing that field as an "ordinary, prudent operator," with "due diligence," or whatever the standard is.

Commissioner Smith: The producer has an obligation to operate the field in a prudent manner, as a prudent producer, or with due diligence, or other legal terms defining the standard by which he will operate the field. He has this obligation to the landowner.

Mr. Johnson: Yes.

Mr. Smith: Under the typical reserve ratio-type of contract, or delivery capacity contract, do you not return, once you go through the steps, to the prudent-operator standard, and doesn't the producer owe an obligation to the purchaser of the gas to operate the field prudently?

Mr. Johnson: Absent a specific provision in the contract, I don't think there is an implied obligation. Some contracts give the pipeline the right to enforce such obligation. Some merely provide the producer will deliver whatever gas is available at that time. That does not mean he is free, as Your Honor points out. He has the obligation to the lessor and to the State Commissions.

Commissioner Smith: But not to the purchaser of the gas?

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Mr. Johnson: In some instances, no, sir. Not unless his contract specifically gives the purchaser that right to enforce that obligation.

That gets down to what I think is the basic issue, I think it is really a question of what Congress meant when they passed the Natural Gas Act, and it gets to the basic question of what does 1(b) mean, exclusion of production and gathering.

We have a number of court decisions, they are old, but still the law, which define what that exclusion is. In the Panhandle Eastern case, cited at length in our brief, there is a good discussion by the Supreme Court going to a great extent into the hearings in Congress, discussing the scope of the production and gathering exclusion.

In the Colorado Interstate case, the courts says, this Commission does not have power over whether producers shall drill wells.

In the Phillips case the Supreme Court again said that what is excluded is the jurisdiction over the production activity, and what is included in the Commission's jurisdiction is simply the power to regulate the sale after that activity ceases.

Now, the heart of our position is simply this:

This Commission can not impose a Certificate condition without regard to what is going to be involved when it enforces that condition. What is involved when it enforces this

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condition, the one set out in Section 2.83(d), it involves nothing more or less than regulation of production activity. That is the basic reason we believe that this Commission can not under the law set as a certificate condition what is proposed in Order 539-A.

The courts, in the Sun Ray case, and several other cases, have held that this Commission can not do indirectly by a Certificate condition under Section 7(e) what it can not do directly.

We submit, this Commission could not as a Certificate condition require Shell Oil Company to drill five wells on this tract before they issue a Certificate, because that is production operation, production activity.

We don't think this Commission can make that requirement, because that area is excluded by Congress, and it is reserved to the jurisdiction of the State Agencies.

If they can not do that, we don't think they can do it indirectly by holding our feet to the fire if we can not deliver x-quantity of gas, and thereby indirectly force a capital expenditure.

The Panhandle case and the Central West case hold this Commission can not even require a pipeline to make additional capital expenditures, even to prevent discrimination among customers. With the jurisdiction of this Commission over pipelines and their facilities, if this Commission can not

require a pipeline to make capital expenditures to build pipelines, we submit they can not require producers to make additional capital expenditures for production activity which are specifically excluded under the Natural Gas Act.

Commissioner Smith: With the exception—you could agree that Section 7(b) abandonment authority of the

Commission put some finite limit on producer behavior under a Certificate?

That is, if the deliveries are reduced to the point that we have effective abandonment, then this Commission authority comes into play, does it not?

Mr. Johnson: There is no question under Sunray but what this Commission can prevent a producer from discontinuing his field from pipeline A and making delivery to pipeline B.

I think there is a question whether this Commission has the authority over partial abandonment, which is occasioned by nothing more than depletion of the field.

In other words, there are two sections of the Act which conflict here, as we see it. There is the Commission authority under Section 7(b) if it has authority over partial abandonment, and I invite your attention to that section, which says specifically, the Commission has authority over partial abandonment of facilities, and it does not say the Commission has authority over partial abandonment of service.

I think there may be a distinction here. But not to

split hairs on the statute language—

Commissioner Smith: It is an important hair, Mr. Johnson.

You are saying this Commission's Section 7 Authority comes into play only when deliveries are totally terminated and beyond that when certification is sought to commence those deliveries to another purchaser?

Mr. Johnson: I think that is right. I would like to answer that with a reference to the FPC Panhandle case, and a discussion by the Supreme Court which appears at 337 U.S. page 508.

There the Court was discussing the argument which the Commission Counsel, or the Solicitor General on behalf of the Commission had made to the Court, which I think is similar to the point you are making, that the Commission's Authority under Section 7(b) over abandonment would prevent sale by Panhandle Eastern of certain oil and gas leases, because to do so would require a partial abandonment of the service.

The Court said this, having referred to Sections 4, 5 and 7(c), "Anything in the Sections indicate that the power given to the Commission over natural gas comes by 1(b) could have been intended to swallow all of the exceptions of the same section and thus extend the power of the Commission to the constitutional limit of Congressional authority over commerce. The repetition of the words 'subject to the jurisdiction' makes it clear to us the intent to keep the

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Commission's hands out of the excepted local matters."

Then the Court, skipping down, says:

"The Federal Power Commission leans heavily on Section 7(b) which provides that natural gas company may abandon any of its facilities subject to prior approval of the Commission. Argument here is since natural gas is the lifeblood of a pipeline system a company by disposing

of its gas reserves unhampered by Commission control may render itself unable to continue service, consequently abandonment of facilities and service without consent of the Commission will result. The argument begs the question. The section, like those above, covers only facilities subject to the jurisdiction of the Commission."

So I think the answer is that the language of Section 7(b) is circumscribed, as I read the Supreme Court Decision by the exclusion in Section 1(b) over production activities.

I am saying, if this Commission is required in its authority under Section 7(b) to abandon, which we do not concede, but if it is required to consent to a partial abandonment, and that consent involves a direct or indirect regulation of production activities, then we believe the exclusion under Section 1(b) controls.

Commissioner Smith: I am not certain that you are positing a conflict which does not exist. I think the service certificated will be service of a depleting resource, and that

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that partial abandonment, as you call it, is probably not an abandonment at all, but simply a characteristic of the service certificated.

Mr. Johnson: I certainly agree.

Commissioner Smith: This Commission has not ever taken the position that it was necessary to file each time and ask for permission to do that which is physically necessary for it to do at any rate.

But in searching for the obligations which you are willing to concede are imposed by the certification process, you conclude as far as the Commission is concerned there are virtually none until the point that production ceases.

Mr. Johnson: That is right.

I also would add, I think that was the intent of Congress, and producers have the obligations we have discussed.

Commissioner Smith: The producers' obligations are contained in the contract and are a private obligation.

To what does the Commission look, then, in certificating a pipeline? The strength of those private obligations?

Then is it in the position of having to say, "They look like good contracts so the expenditure of money for the pipeline is in the public convenience and necessity."?

Mr. Johnson: The Commission knows more than that. It knows the reserves in the field. This is of course one of the

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requirements pipelines have to submit and the Commission Staff reviews it. They have no doubt but that those reserves are committed. And they can prevent any effort to divert those reserves to anyone else.

The pipeline has its contractual rights with the producers. The producers have their obligations, as I have discussed, to properly produce the field.

I don't think there is a gap here, or any danger that something will happen to let that supply get away. We are only talking about the rapidity with which those reserves will be delivered into the pipeline.

It really gets down to the question of who makes that judgment.

We submit that it is proper and right for the person to make that judgment who will spend the money to drill the wells. We think that is what Congress intended, subject to the regulation by the State body to be sure there is no waste committed, and the correlative rights of parties are protected, and the contractual rights of the pipeline are protected, and the lease obligations are protected.

Where is the gap? We don't think there is one.

I think that brings us to questions of policy, which I would like to save for my rebuttal, and listen to some of the other policy arguments. Perhaps I can answer in that context.

Commissioner Watt: Your sense of timing is very good,

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Mr. Johnson.

In the rebuttal, would you address your attention to a subject you outlined and tell us your views of 359-A as a policy statement, excluding the 283 filing? If that situation were severed, would you have a problem with a mere statement of policy embodied in the words of

359-A, and then (b) is 2.83(d) to which you really object, is it?

Or must they be tied together in totality?

Mr. Johnson: We would like to see dropped 2.83(d), which is the teeth in the Order. If that is deleted, the question then is "What does the Order stand for?"

I think that area of uncertainty is undesirable, but it is a lot better than the Order says now.

Commissioner Watt: Thank you.

The Chairman: Thank you very much, Mr. Johnson.

The next, Consumer Federation of America.

ORAL ARGUMENT OF
CHARLES F. WHEATLEY, JR.
CONSUMER FEDERATION OF AMERICA

Mr. Wheatley: Mr. Chairman, Members of the Commission:

My name is Charles F. Wheatley, Jr. I wiil present the argument this morning on behalf of the Consumer Federation of America.

CFA is a coalition of some 200 national, state and local consumer and consumer oriented organizations with total membership of over 30 million people. The association and

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standard of Order 539.

On page 5, for instance, in the first paragraph—

Commissioner Smith: 539-A?

Mr. Wheatley: Yes.

There the Commission refers to its earlier Order and says:

> "That order merely reiterated the Commission's authority to enforce all obligations including any delivery obligations that are set out in a contract between a producer and a pipeline and certificated by the Commission."

I think this kind of reverses the thrust of the original Order, which was very clear on page 6 that as certificated factors dealing with contractual terms may or may not accord with the terms of the Certificate, and that the Commission was going to rely, clearly and first, on the terms of the Certificate.

We feel the clear-Cut standard is the terms of the Certificate. The Commission has clearly set forth the maximum annual quantities and the peak-day quantities, plus it has made decisions on deliverability.

We think those standards should be the ones that follow, and the producers having permitted their contracts to be used as underpinning for that decision, can not be heard to object.

upon which their contracts were submitted.

We believe they are not bound by the terms of the Certificate, once issued by the Commission as a final order, and it should only be changed by a formal request to amend.

The type of enforcement proceeding outlined by the Commission in Order 539, we think, is commendable and should be encouraged.

The Commission does have procedures available to it under Section 20 of the Natural Gas Act to require enforcement of its Orders.

We are not here talking only of future certificates, subject to 2.83(d) but we think the real ballgame here is in past certificates, which are in desperate need of enforcement, and we believe the Commission can make a vitally needed new contribution to the gas consumers of the nation.

Thank you.

Commissioner Smith: Mr. Wheatley, can the obligation be any more than "due diligent" obligation, or a "prudent operator" requirement?

Mr. Wheatley: I think it can. Where a pipeline and producer join together in contracts and a certificate application is brought in with all of the detailed gas supply information that is required there, at that time we are talking of millions of dollars of investment based on the veracity of those supply estimates. This Commission would never certificate a

pipeline to expand its facilities if it does not have a gas supply for more than just two or three years.

We are talking about the very heart of the entire gas industry in this country which underlies these certificates. I think it is a question of very significant importance.

Commissioner Smith: Where the "prudent operator" tests were being applied, and the explanation given for the drop in deliveries was a physical one, then is there anything the Commission or anyone else could do about that?

Mr. Wheatley: I think the procedure that should be followed is for the parties who originally underlay the original certificate to comport and ask the Certificate be amended because of changed circumstances. That is the proper procedure they should follow.

And at that point they should bring in their evidence of why those wells are being sanded up.

I am tired of being told in curtailment cases that well, wells are sanding up, so you are not getting the gas.

I think the producers have an obligation to meet those requirements. They have their day in court to seek an amendment.

But that procedure is the one that should be applied. The Commission Staff is able, and can review any application for an amendment and determine on the record whether or not the company does have a justified reason, as you have assumed

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in your question. If they have, I think that would be a valid basis for the Commission to amend the Certificate.

Commissioner Smith: One final question:

539 used the phrase "daily minimum delivery requirements" which comments were taken issue with.

I notice you used "annual delivery requirements" and "peak day requirements" as being objectively ascertainable delivery obligations, and not daily in the sense of 365 days a year.

Would you suggest we focus on those two objective standards as opposed to attempting to refine it further?

Mr. Wheatley: I think those are the standards the pipeline must meet before it can justify expansion. It has to show that it has a gas supply to meet a certain peak day requirement on the pipeline, and it also must have enough gas to meet the annual volumes.

Those numbers are very precisely set forth in the application. The gas supply back of that either does or does not do it.

Commissioner Watt: Have you reserved any time?

Mr. Wheatley: Unfortunately, Your Honor, I had only twenty minutes.

Commissioner Watt: Mr. Chairman, excuse me for trespassing on someone's time.

I was surprised by your comments about looking to the

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Commissioner Holloman: Assuming the Commission does have that right, and assuming a situation where the Commission detects either through the information from the producers or through a complaint by a pipeline or some other party that deliverability in a certain field has dropped off in a peculiar way, suppose the producers do produce evidence that under the terms of the contract in applying the due-diligence test they can no longer maintain the deliverability of that field, now at that point what is the obligation of the Commission then?

Assuming that under the clear language of the contract and applying the due-diligence standard the Commission determines the deliverability can no longer be maintained in that field under the terms of the contract, then what other alternatives does this Commission have?

Mr. Wheatley: At that point in our view there should be a full hearing, where these facts would be laid on the record and, we would see the basic data on which the producers make the claim, and test it on cross-examination.

Assuming they pass those hurdles, then if in fact there were no alternative areas backed up to supply—as a basis for the supply in the original supply, then I think the Commission would have a case, in my view, to amend the certificate at that point.

Now, if on the other hand there are other—

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The Chairman: Thank you, Mr. Wheatley.

Next, Tenneco.

ORAL ARGUMENT OF GORDON GOOCH
TENNECO OIL COMPANY

Mr. Gooch: Mr. Chairman, may it please the Commission:

My name is Gordon Gooch. I am here to speak for Tenneco.

Let me begin by setting aside the point Mr. Wheatley predicated his primary argument on.

As I understand Mr. Wheatley, he argued that the Certificate obligations undertaken by a pipeline under new construction somehow could be imputed back to the original producers and therefore be bound to whatever delivery obligations the pipeline assumed in their initial certification.

I call to your attention that under Section 2.61 of the Commission's Regulations, particularly Sections (a) and (c), a pipeline does not even have to show a 12-year deliverability life any more.

Twenty years ago the pipeline had to show twenty years of reserves, in terms of deliverability. Today the Regulation reads:

> "When a pipeline company has demonstrated through the annual reports filed pursuant to Section 2.60.7 of this chapter that it has an active gas procurement organization and its pipeline system extends into production areas in which exploration is continuing,

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> the 12-year deliverability life heretofore found to be a primary requisite by the Commission will not necessarily be applied and the Commission's deliverability requirements will be flexible."

Under the Commission's own regulations, it seems to me unreasonable to impute each requirement to a producer. When a pipeline need not show any number of years of deliverability the producer will from then on, I assume, pick up his pro rata share of the pipeline's delivery obligations.

Nor am I aware of any—of any—producer regulation whatsoever in the certification process that calls upon the producer to file any sort of maximum day or any sort of obligation as described by Mr. Wheatley.

In some cases currently evidence of this nature is sought from the producers, but it is clearly estimates. And it converts those estimates into warranties, is the natural result of what Mr. Wheatley has argued.

Now, there seems to be, I suppose you would say, a perhaps "unstated", or perhaps "underlying" concern, that the producer is not delivering what he can deliver. This Commission has already had a recent case, a show-cause case, concerning Tennessee, in which Tenneco Oil was a party. The Tenneco witnesses testified in that proceeding, reviewed by this Commission, that they ran their wells cherry-red, pushed them to the point of physical safety, to make the

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deliveries.

On the basis of unsubstantiated allegations, not on the basis of any evidentiary record, the entire producing industry is called upon to accept a certificate condition. That certificate condition says, for the first time that there is a certificated minimum daily delivery obligation. And in an effort, a sincere effort, to review that and advise a client as to what that means, the answer has to be "I don't know. I don't know what that is."

It can not be the take-or-pay provisions in the contract. The take-or-pay provisions are for the protection of producer, for precisely the opposite reason from that given this morning. Those take-or-pay provisions came basically at a time when the pipeline had the upper hand, and there was excess supply of gas. And the pipelines could use the producers to have their own in-bound storage fields to pull on when they wanted to, cut them off when they did not want them, in the absence of take-or-pay.

Those take-or-pays perform a public function for the producer today, with the advent of the production of supplemental supplies the take-or-pay will perform the same function—it will guarantee the producer will not have his wellhead production cut back to that a supplemental supply goes to the pipeline instead.

We are not here to argue the relative merits of whether

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take or pay is a good or bad provision. We are here to

discuss whether or not it imposes an obligation on the producer. If it does, it will be the first time anyone ever thought it did. If that is all it takes, I suppose producers can drop them from contract in the future, give up take or pay, and therefore give up any obligation tied to the take or pay.

Commissioner Smith: Mr. Gooch, do you have a standard producer contract that you require the pipeline to sign now?

Mr. Gooch: Tenneco has two basic types of take or pay. One basically deals with a calculation of reserves, and the other is on deliverability.

Commissioner Smith: Who drafts those? The producer?

We have been told there was a time when the contract could be written by the pipeline, and that is no longer the case.

Mr. Gooch: From personal experience, I can not go back too far in this area. But the take-or-pay provisions as you see them back for twenty years, or so, have been in producer contracts, and I picked up in, I suppose, the liturgy of the profession as to who proposes them now. I view them as for the protection of the producer, and that they are so calculated and operated. So I suppose the producer, by and large, insists on the inclusion of them.

Assuming we can face the prospect that if take or pay is to be considered to be a delivery obligation for the first

time, the producer therefore will drop the take or pay.

What is left then?

In the condition that would be inserted in the Certificate it says: "The certificate minimum daily delivery obligation is what the contract says unless otherwise changed by the certificate authorization."

So I ask, what does that mean? Does it mean the Commission will set a minimum delivery obligation in the Certificate and the producer must deliver forever whatever daily quantity the Commission puts in the Certificate, or else get a certificate amendment before these quantities have been reduced?

But that is not the only place the problem comes.

Paragraph 2 says, the Certificate condition "shall be without regard to any contractual reservations contrary to the certificate authorization."

When, what does that mean? If we file a contract, and it is accepted at our rate schedule, and we get a certificate, will someone tell in the Certificate that certain provisions of our contract have been excluded? Or do we find later, as we live up to the contract, that contention will be made by Mr. Wheatley or someone else that the certificate has inherently and sub silencio overruled part of your contract provision?

Are we not entitled to know before we accept a certificate what minimum daily obligation is to be imposed on us, what

provisions of our contract are going to be excluded?

Third, "The Certificate obligation shall remain in full force and effect unless and until changed by appropriate certificate amendment based on applicant's full presentation," and so forth.

The pipeline dispatcher will call us, I guess, and tell us to cut back on deliveries, so we cut the wells to half because storage is full, it is about to go over from the heating season, they do not need all our gas, they cut his back.

It happens in the fall, even in this day and age.

What do we do? Abandon service? Can we deliver less than the minimum obligation?

We do constantly have mechanical problems. We file a report every month with the USGS giving a monthly report well-by-well of the volumes and reporting any difficulties or problems with the well—sanding up, mechanical difficulties, workovers. Those are public information of public record.

The plain truth is, and the reason I back slowly into the Outer Continental Shelf, is that the producer is a hostage in the Outer Continental Shelf. Onshore he has a choice to accept or reject the certificates, because he can go somewhere else.

Offshore he is a hostage.

So let us focus on this offshore producer. The USGS has almost unlimited control, subject to reasonableness, over

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the producer. Section 250.33 of the Geological Survey's regulations gives the Interior Department the power to order drilling, order producing obligations.

Now, to the extent that there is an unstated concern in the offshore federal domain, or perhaps a stated concern, that the producer is not delivering all that he can, which I believe is contrary to the fact, let me call to your attention that the Energy Policy and Conservation Act enacted by the Congress on December 22, 1975, has a Section 106 that gives to the President of the United States the power to order all producers on any federal lands to produce all wells, oil or gas, at their maximum efficient rate of production.

To the extent to which Order 539 is envisioned as some device, assuming it were necessary, to make producers deliver everything they can, I suggest to you the Congress has already allocated that function.

The extent to which 539 is perceived as an effort to impose some heretofore unknown or undiscovered obligation on the producer let me suggest that it is both unfair and unwise. Unfair for someone to find out now that they have some obligation, that someone else is going to tell them, on drilling and development, something they did not take on in the certificate, something not in their contract, something even yet to be articulated, as a standard by which one can even judge his own conduct.

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The Chairman: Counsel, excuse me.

To go back to this point as it relates to your earlier point talking of the offshore areas, you pointed out that USGS has authority and the President also has authority to require certain things.

In conjunction with the requirements of prudence, prudent operation, or due diligence, whichever one, do the producers now go to and participate with USGS, or FEA, if that is the appropriate agency, in determining this prudency; in other words, when a well is deemed by the producer to be in danger of some kind, do you then go to USGS and say "In operation of our prudency requirement we are here," and so forth?

Do they participate in the prudent or due-diligence decision, offshore?

Mr. Gooch: Yes. You file, among other things, a Form 9521, where you report well-by-well the operations on a monthly basis. You have to submit work programs. They have inspectors. You deal constantly with these people. They are your supervisors.

The Chairman: At least when they want to exercise their right they can inspect the well and see if the danger is there?

Mr. Gooch: Oh, sure.

The Chairman: Does that apply also on onshore with regard

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to the States?

Mr. Gooch: Onshore, sometimes the State is your landlord, too—it might be State School Lands, or something like that—as well as the State being your regulator.

And where you have the State as the landlord the State takes a very active interest in what you do.

When you talk about the State as regulator on private-owned lands they will be primarily concerned with the fact you do not damage the reservoirs and that the materials, the hydrocarbons, condensate, crude, whatever, natural gas, in fact finds their ways into the market and are not vented or flared or abused.

The Chairman: So it would be your general position, if I understand you, in the determination of deliverability from wells in the case of offshore the USGS participates or determines whether you are fulfilling that, and in the case of States the State Commissions perform that function?

Mr. Gooch: No, I am not saying that.

I am saying to the extent it is perceived that there is a problem in the offshore federal domain, if someone believes the producer is not pulling on his wells, there are two different federal remedies already in existence. One is the landlord supervision by the Department of Interior. The second is the power given to the President of the United States under the Energy Policy and Conservation Act to order

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maximum production.

I do not wish to get away from the other point, which is that the actual operation of these leases and fields onshore or offshore is at the first interest by the producer. And I do not want to get away from the point that there is nothing in the certificate issued by this Commission, nor within the ambit of its jurisdiction under Section 1(b) that would substitute this Commission's judgment for the producers, for the interest of the Interior, or the President of the United States, under EPCA.

Commissioner Smith: The producer does have the obligation to operate the lease as a prudent operator, does it not, Mr Gooch?

Mr. Gooch: Taking into consideration the way that formula may be described in different jurisdictions, I really can not claim I can tell you for sure that is standard in Mexico or Oklahoma. But as a general proposition, I think that is correct.

Commissioner Smith: To whom does the right to enforce that obligation run? Only to the landowner?

Mr. Gooch: Yes.

Commissioner Smith: And the purchaser under the standard gas contract has no rights thereunder? The purchaser of the gas, the pipeline?

Mr. Gooch: If the pipeline wishes to be the developer

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of a lease—

Commissioner Smith: No—

Mr. Gooch: Please let me finish?

We think they have the means to do so. You let the pipelines buy leases, develop them, put them in rate base. And then the pipeline has total control over production and development.

In a producer contract situation the producer has that right. Under the contract, the producer has the exclusive right.

Commissioner Smith: Under the prudent-operator standard no one is empowered to bring action to enforce that standard except the landowner?

Mr. Gooch: I believe that is substantially correct.

Commissioner Smith: Well, the pipeline purchaser then has what right to complain to this Commission when abandonment has occurred without authorization?

Mr. Gooch: The implication of that is that an abandonment has occurred. If we took a specific case of abandonment, I suppose, and there are plenty pending before the Commission, we could examine the facts of a particular abandonment.

But the implication is that the producer is not developing his field in an orderly, conscientious fashion.

Assume for a moment that he is not—that he is not. Does the pipeline have a contractual remedy, absent some unusual

provision in a producer pipeline contract the answer is No, he has no contractual remedy.

Commissioner Smith: Then the sole-discretion clause can not be penetrated by the pipeline in any kind of proceeding?

Mr. Gooch: We are arguing contract law now, and I am projecting what some State Court Judge in McAlester, Oklahoma, or the Federal Judge in Houston, or the District Court in Albuquerque, may do, but I project that is the result that would be reached in a court that would handle this sort of thing. If a pipeline wishes to assert a contract claim against a producer that is what the courts are for.

This is just, I think, unfair—

Commissioner Smith: And there would be instances where the pipeline might, contrary to your position, successfully assert in a judicial forum that it had enforcement rights because the lease had not been operated prudently?

Mr. Gooch: It is entirely possible that that could happen.

Commissioner Smith: However, this Commission is in no way a third-party beneficiary, or in any other legal posture to be able to enforce that?

Mr. Gooch: That is right. You authorized—you authorized—under Section 7 a sale-for-resale in interstate

commerce. You had the contract in front of you. You have

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regulations that say "We will not permit you to collect your contract rate."

You have provisions that say "We will not consider a contract that has a favored nation clause in it," and such. Don't bring those in. If you bring in a contract that does not have those provisions, we will look at it and decide if it is in the public interest, and certificate. Under that certificate you agree under the Natural Gas Act that you can not sell that to anybody else until you come to us for permission. You have the start under Section 7, and the end under Section 7. In the middle, absent a proceeding under Section 4 or 5 , you have no authority. And 4 and 5 would be rates and discrimination.

Commissioner Smith: Then any provisions in the contract which would be incorporated in the certificate and attached to the rate schedule that is publicly filed confer no enforcement authority whatsoever on this Commission?

Mr. Gooch: Well, let me say this: I do not believe—perhaps wrongly—that the resolution of what we are here talking about depends on that answer. I think that answer could be yes or no, and it would not lead to any significant difference in the result here.

The question is: Can you, with the limitations under Section 1(b) condition a certificate to require a producer

to drill and develop his leases by standards that you set either

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now or with an open-ended blanket thing in the future?

Commissioner Smith: I think that is a hard and difficult question, Mr. Gooch. And that is what I want us to address.

What I am somewhat taken aback by is the fact the conditions accepted by virtue of the acceptance of the contract are not enforceable by this Commission.

Mr. Gooch: I will be willing to concede for the purpose of this argument that you can enforce anything—Btu stripping for the purpose of this argument. I could stipulate we could hold court here and you could try every issue—right-of-way claims, everything; because I do not think it detracts from the basic argument we are making.

Commissioner Smith: Then the prudent-operator standard—it then becomes important to decide whether this is a condition of the contract. And your assertion is that the sole-discretion clauses make the "prudent operator" standard either non-existent or meaningless, or subject to definition by the actions of the producer in each case?

Mr. Gooch: That is right.

Commissioner Watt: I would like to pick up there.

The contracts I am familiar with are certainly heavy on that "sole discretion" of the producer. So I get confused.

And I am going to ask a question, to help me understand the definition of a "certificate."

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From the discussion this morning, I would be led to believe a certificate is something you just hang on the wall.

The ones I am familiar with simply by reference adopt the conditions of "the contract" which I call a "producer contract."

Mr. Gooch: From this concept, I assure that that they were, which is fine.

But the certificate I am aware of does not add any new conditions other than we know about in the statutes, regulations, and the contract. There is no new figure or new number put in it. I need edification on this. I get the idea so far there are contract terms and certificate terms, and I do not see a distinction.

Mr. Gooch: My analysis is exactly the same as yours. When you get a certificate, if the Commission is into something, they write it down, not in the body. You asked if there were a difference in language between 539 and 539-A. 2.83 is the same in both of them. You don't know what you are doing under either one, with or without the language, because that language may or may not be part of the certificate.

When you get the certificate you look for the conditions and try to determine whether you can accept or reject the conditions. They are written, and you are supposed to be able to be put on notice.

To me the concept of a—of having an implied condition

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that sets aside a contract clause that you have impliedly, is repugnant.

Commissioner Watt: I woul[d] hope so.

Commissioner Smith: The contract clauses are self-imposed conditions that you do accept.

Mr. Gooch: Yes. But I am talking about saying the silence of a certificate as an operation of law will set aside a contract provision that you have submitted to the Commission and gotten back a certificate without a condition; and that is what Mr. Wheatley argues.

Commissioner Watt: Are you familiar with any instances in which the Federal Power Commission has issued a Certificate which goes beyond the terms of the contract with regard—I will make all my contract comments with regard to the delivery issues. Are you aware of any certificates that go beyond the terms of the contract for delivering gas to a pipeline?

Mr. Gooch: You have certain cases pending before you now where the Commission is attempting through

use of the certification power, with the hostages in the offshore federal domain, to extend their contracts. As to the ones actually being done or not, I hope the answer is no.

Commissioner Watt: If we speak historically, the answer is "No."

Mr. Gooch: Historically, the answer is "No."

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Theoretically, the conditions accepted in a certificate are voluntary, you are willing to live up to them. That works onshore, it does not work to well offshore—if I have time left I would like to save that for rebuttal.

Commissioner Holloman: What is the situation with respect to time? Do we have discretion to extend time on our motion? Because I want to get down to this point:

You are saying that when the pipelines came before this Commission and asked for a Certificate of Public Convenience and Necessity to build a pipeline to serve customers, then they came in and the underlying document was the contract that the Commission looked at to determine whether or not to issue that certificate, and, as Mr. Wheatley says, billions of dollars were invested in the pipeline, billions of dollars were invested by consumers, tremendous commitments made by many people, on the basis of that obligation, and you are here today saying that once we issue that certificate we are in no position to enforce those obligations, whatsoever, that short of abandonment, total abandonment this Commis-

sion does not have the authority to protect the investments people have made and relied on, that this Commission has issued the certificate based on, and in fact given the power of eminent domain of the United States Government to these pipelines, and they are totally unenforceable?

That is what I am hearing, and I want to know if that

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is correct.

Mr. Gooch: I would like to answer, although my time has expired.

Your statement is not an accurate description of what I said.

I say what you are talking about is the pipeline certificate. When you say "the obligation of the pipeline," whatever obligations the pipeline took on for deliverability, I ask you first to consider how you impute that back to the producers.

The producers did not take on that obligation.

What obligation did the pipeline have to show—

Mr. Holloman: The producers have contracts with the pipelines. On the basis of those contracts, the Commission looked at the contract between the producers and the pipeline, I assume, and partially on that basis issued the certificate.

Mr. Gooch: That is exactly the point I am coming to. What did the Commission certificate? Depending on the

year the certificate was issued, they found perhaps 12-year deliverability life. So for a pipeline certificated in 1945 they would have found a 12-year deliverability life, to, say, 1957.

Does that mean a producer in 1976 must maintain deliverability of what his contract was for in 1945?

Suppose you take the ARKLA case, or the Trans Western Expansion case, where you had two or three years deliverability,

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and in ARKLA, if I recall right, you had no deliverability, it was zero.

Now, what obligation did the producer pick up? Did he pick up an obligation for the rest of eternity to maintain deliverabilities that his contract were estimated to be good for in that first year or in the second year or in the third year?

I say no, he did not.

I say it is unfair to charge him with the duty of maintaining deliverability which he never—never—undertook. And the pipeline did not undertake it, either.

They undertook, as you have in the regulations now, to try to acquire new gas supply.

Commissioner Smith: Did the producer undertake any obligation whatsoever?

Mr. Gooch: Yes. He understood the obligation to sell to the pipeline all he produced subject to such reservations as reinjection to bring up oil, or lease use, that sort of thing.

Commissioner Smith: And that is all?

Mr. Gooch: That is right. That is right. He undertook to sell what he produced. And you have to be, I suppose, not surprised to learn that the producers have to drill wells to make their money; they can not simply drill one well on, say, a 100,000 acre or 300,000 acre tract, and make any money. They are going to optimize, it is to their own

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self-interest to optimize. And the implication is that the producer does not want to optimize.

I say if that is the implication let's have evidence on it, and stop branding us on allegations alone.

Commissioner Holloman: Then is it your position, Mr. Gooch, that under the certificates that are currently issued, have been issued, by this Commission, the producers have no delivery obligation whatsoever other than that which they choose?

Mr. Gooch: No. Other than that which is in the contract.

Commissioner Holloman: And if there is no provision in the contracts they have none at all?

Mr. Gooch: That is right. And this Commission looked at those contracts when they were filed, and it was asked

whether it was in the public interest to allow these contracts to be used in interstate commerce, and the Commission made no objection whatsoever. There was no rejection of the Certificate, no outlawing of those contract provisions. There was no indication that it was anything other than in the public interest.

So I ask you, is it fair to say today they are not in the public interest?

Commissioner Holloman: You do acknowledge they are obliged to meet the terms and conditions of their contract?

Mr. Gooch: Certainly. Absolutely.

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Commissioner Holloman: It has been suggested that this Commission has no enforcement responsibility or authority even with respect to those.

Mr. Gooch: As I am concerned, I say that is immaterial. If this Commission wished to try contract issues, I have no objection. I don't think that is where the case turns. If the Commission wanted to try contract issues, I am sure all you have to do is to issue a show-cause and we will have to try it whether or not we think this is a proper forum.

So I don't think that is the test, as to which forum you use. Although I do believe this Commission has held previously in numerous cases that contract issues are for the Court, not for the Commission.

I do not make that a point here. This matter does not turn on where the forum is for resolving contract disputes between the producer and the pipeline.

The Chairman: Thank you, Mr. Gooch.

We will take a break for about ten minutes, now.

(Whereupon, at 11:10 a.m., a recess was taken to 11:25 a.m.)

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Chairman Dunham: The next witness represents the Interstate Natural Gas Association of America.

ORAL ARGUMENT OF
JEROME J. McGRATH
ON BEHALF OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

Mr. MC GRATH: May it please the Commission, my name is Jerome McGrath. I am executive vice president and general counsel of the Interstate Natural Gas Association of America, which is also referred to as INGA.

We appreciate very much the opportunity to present the views of the pipeline companies in this most important matter. As the Commission undoubtedly already knows, INGA represents all the major pipeline companies operating in the United States today. Our companies account for over 95 percent of all gas transported

in interstate commerce, and we have a vital interest in any action the Commission may take which will affect the gas supplies available to our systems.

We, that is the Commission and ourselves, have a common goal, which is to assure as best we can by the means we have available obtaining of adequate natural gas supplies to render service to the consumers throughout the United States.

We fully appreciate the Commission's concern about the declining supplies for the interstate market, and the efforts it has made to improve those supplies, operating under the legal and statutory handicaps that exist today.

So it is with some regret that we must take issue with Orders 539 and 539-A, with all due respect to the

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Commission. And, with all due respect to the Commission, we think they were ill-conceived and ill-advised issues.

The pipelines have been greatly troubled by these orders since their issuance, and, as the Commission itself noted in 539-A, the imposition of the conditions in Section 2.83(d) upon producers has literally dried up gas supplies today, and in this day when the pipelines bend every effort to find every cubic foot of gas they can collate, it compounds and makes even more difficult our gas-buying efforts.

Commissioner Smith: Mr. McGrath, I want to be clear on what you would have the Commission do.

As I understand it, INGA would have the Commission rescind the orders in their entirety.

Mr. McGrath: Yes, sir. We do not think they contribute in any measurable way to the gas-supply situation or to improving the pipelines' ability to render service to their customers.

As a matter of fact, they have had a counterproductive effect, and for justifiable reasons I hope to spell out later here.

One of the problems, of course, is that this is creating an obligation on the producers which neither the pipelines nor the producers thought was there, and which is in fact not there, whether you turn the contract upside down, inside out, what-have-you.

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I think we may be getting off the track a little this morning on what the problem is, as I have heard the arguments.

In Order 539 the Commission says the parties have seized in the words "certificated minimum daily delivery obligations." And indeed we have. Because that is the problem: There is no such animal.

The producer does have an obligation to the pipeline. I think Mr. Wheatley obfuscated the whole situation by his reference to the filing requirements, the regulation of the pipelines under Section 57.14. We should examine those very closely, to see just what it is the pipelines are filing and the Commission is certificating.

Exhibit H is indeed a gas reserve exhibit, showing estimated reserves behind a given contract, and shows the contracts on which the companies rely. They are submitted on estimated deliverability studies, which are on an annual basis.

The contracts provide for the sale of gas on an annual basis or for a period of time covered by a particular contract. The producer agrees to sell to the pipeline company the reserves covered by the contracts which the pipelines have submitted to the Commission in support of their certificate, in support of their application. This is what the Commission certificates.

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Nowhere does the Commission certificate or is there any basis for it to certificate a minimum daily delivery obligation. It cannot be done, we submit, because of the varied nature of the resources with which we are dealing, i.e., natural gas. Every day a well is produced that gas is gone, the reservoir is depleted to that extent. As the reservoirs deplete, as Mr. Johnson's chart shows, the ability to produce goes down.

The pipeline companies in their exhibits—Mr. Wheatley referred to Exhibit I, which is a market exhibit—demonstrate the markets they would intend to serve. And there are peak-day delivery obligations by the pipeline to meet that market requirement. How does he do it? He does it by the gas he buys from them, from Phillips, from Amerada, from whoever. He does it through linepack, through storage; he is operating his system really as a balancing act. And one day I may take 100,000

mcf per day from Shell in the XYZ field, 50 from Phillips, and 150 from storage, and I am meeting the peak day requirement shown in my Exhibit I, which was certificated by the Commission.

The next day the dispatcher says "I think I will save the XYZ field, because it has a little more produceability, for a colder day, so I will cut my takes from Shell's field to 50 a day, boost my take from Phillips to 100, all within the terms of the contracts under which we operate, and which govern out operations and purchases from producers, and increase

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my storage by so much."

Mr. Wheatley gave you apples and oranges in telling you that you have certificated a peak-day volume for the producers to deliver. He said there was some regulation covering this. Well, I wish he would cite it for the record, because I am not familiar with it. It may be there. If it is I think we ought to have it for the record.

This is the problem we are facing: You are trying to impute a delivery obligation which just is not there. What is the reason for the producers—we think justifiably so—refusing to accept a certificate which says that you have to live up to a minimum certificated daily delivery obligation.

What is that obligation; Is it 100,000 a day from the Pecan Island Field, from Exxon? What is it?

We as the pipelines are told that well, you can file a complaint, or you should be enforcing this delivery ob-

ligation. And you invite other parties to come in and file lawsuits to enforce an obligation.

And what is it? To what are we agreeing when we accept a certificate with that language in it, when we cannot physically do it?

Take a case of a field with casinghead gas produced with oil, where the pipeline must purchase all the gas produced when they are producing oil. If the field is shut in and they are not producing the oil, for reasons of conservation, or

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whatever, what is the "minimum certificated daily delivery obligation"?

Suppose the production from the field varies day to day. What is the minimum amount?

To me it is inconceivable that the Commission would knowingly impose such an obligation that they cannot meet. Take shallower fields, such as Hugoton, in Kansas, Texas, Oklahoma, where state allowables govern. These pro-rations are determined from time to time by the State commission, for reasons of conservation; or you have a field operating as a unit, with rateable takes from the wells, depending not only on the reserves underlying the particular wells, but on the line pressure on the pipelines that are taking the gas.

There are a myriad of physical factors which come into play in terms of making gas available to the pipelines and bringing the gas to market.

And it was not without reason that Congress recog-

nized there are a myriad of physical and economic factors which are peculiar to the producing industry, and said this is not the domain of the federal government local conditions and local factors must be taken into account; and Congress excluded production from the jurisdiction of the Commission.

But we as pipelines are going to make the producers live up to their contracts. We do have rights under the contracts.

You have dozens of kinds of contracts, and this is just

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one that I have here, Your Honors:

"The seller commits to the performance of this agreement all gas produced from and attributable to the interest of the seller in the lease and lands" described in the exhibits attached to the contract.

Of course, that reserves the right for lease use and the lessor's requirements, so on.

The contracts also provide that the seller "during each year agree to sell and deliver to buyer and buyer agrees to purchase and receive all of seller's share of the following quantities of gas," and they are described.

We are not operating in a vacuum, as was indicated this morning. The pipelines do have billions of dollars invested in facilities. They do have an obligation to protect that investment. And we are doing the best we can. And I can say, based on the information we have, that we are buying all the gas to which we are entitled in the fields and the producers are producing gas to the fullest extent

they are capable of producing, to meet the demands the pipelines are making.

You may have exceptions here and there, but by and large the pipelines are buying the gas they are requesting from the producers, within the capability of the producers to produce in the given field, and taking into account any state regulatory orders or conservation control measure that might

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apply.

Commissioner Watt: Have any of the pipelines found it necessary to take the producers to court on this issue you are talking of today?

Mr. McGrath: To the best of my knowledge, Commissioner Watt, no. But I do not pretend to know all the State proceedings that might have taken place. I am not aware personally of any.

Now, this is where we have our deep problem, that is that the words you have put into Order 539 and Order 539-A are very exclusive. I read them to you, you are familiar with them.

Yet they are very vague and unclear as to what kind of obligation they impose on both of us — the pipelines and the producers.

I as a lawyer looking at the orders themselves, if I were advising a producer client I would have to tell him "Do not accept a certificate from the Federal Power Commission if it is conditioned in this way, because today you

don't know when you accept a certificate, with all of the rights and obligations it may connote and carry, what kind of delivery obligation you are buying, or agreeing to. And if you don't know what you are agreeing to how can you live up to it?"

That is really the crux of the problem, and that is why we are here today.

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We feel it has and it has had a disruptive effect on our operations, on our ability to buy gas. We do not see that it adds a cubic foot of gas to our reserves.

Mr. Wheatley says it is about time the Commission made the pipelines and the producers live up to their certificates. Well, I have news for him; We have been living up to them.

The problem is that the reserves have been declining and no new reserves added. And the search for reserves grows more difficult every day. Some day we hope Congress will see fit to provide the legislative action this Commission needs and we all need, to get the exploration and development activities going and on track in finding gas.

But 2183(d), 2.83 in general, does not help us at all. So why have it, when the clear effect is just the opposite of what the Commission intended?

We submit, Mr. Chairman and Members of the Commission, that the public interest militates against any kind of action which would deter the pipelines from meeting the service we would like to render and which unfortu-

nately, because of our gas supply situation, we are not rendering.

Curtailment proceedings are well known to the Commission; I need not get into those at all. But I do believe the Commission should look at this order very, very closely, and see just where, in the public interest, it lies. We do not see that it does anything to aid us or the public.

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Commissioner Smith: Mr. McGrath, the terms of the contract which the pipeline would regard as giving it a cause of action for brief, does the Commission also stand in a position to enforce those terms?

Mr. McGrath: Well, Your Honor—

Commissioner Smith: Where the pipeline declines to do so?

Mr. McGrath: If the producer failed to live up to the terms of the contract, we look at the contract as a whole instrument, in all of its terms, and in our view the pipelines would have a remedy in court, or, if you will, before the Commission.

I do not wish to get into a discussion of the appropriate forum. But so far the courts have been the proper forum. Whether the Commission would have the right I don't know, sir. I think that is a matter that would have to be tested.

Not being a party to the contract, I suppose you could

direct the parties to show cause for not living up to the contract which was certificated.

However, I think this is a little beside the point, in terms of our problem today with this order, Commissioner Smith. Our problem today with the order is that the contracts do not provide for this, you cannot read it into the contract, you cannot read it into anything we have agreed to or the Commission has certificated.

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And who is going to enforce certain rights under the contract is another question we would meet in another forum, or at another time, if you will.

Commissioner Smith: The 539 problem is in Part 1, where the Commission is allegedly imposing, although perhaps indefinite and unknown, at least more obligations on the producer than he chooses to impose upon himself. And the question is whether that document which represents those obligations he chooses to impose upon himself and those he accepted a certificate with are themselves enforceable.

Mr. McGrath: I think we have to step back a little.

You say that he chooses to impose upon himself. These are contracts entered into by two willing parties, where with arm's length bargaining the parties agreed to certain things, to do certain things, and both incurred certain obligations. We submit that to the Commission. If the Commission does not like the contract, and says "We don't think you have the right obligations or duties and we will not certificate it," you have that authority.

Commissioner Smith: Or can impose additional requirements and the parties can say "We do not accept."

But in this instance, where it is certificated and accepted, do the obligations set out in the contract become enforceable matters as far as the Commission is concerned?

Mr. McGrath: Yes. In my view, yes. I am accepting

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the proposition that when you issue a certificate authorizing the sale of gas and you incorporate in the certificate the contract for the sale of the gas you have, or we have a right, the Commission has a right, to enforce the terms of the contract.

You have to read the contract in its entirety, with all of the terms and reservations of the producers as to due diligence in development of the fields, reserving the right of delivery, making deliverability tests, everything else, and the "prudent operating."

Commissioner Smith: Is the "prudent operator" test—

I don't know what contract you are looking to. Tenneco appended several, one of the reserve ratio, one of the delivery obligation, as examples.

But under the contract you quote from does the pipeline have any rights to bring an action where it feels the operator has not operated in a prudent fashion?

Mr. McGrath: Let me state it a little differently.

In my view, if the pipeline feels that the producer has

not been living up to the obligation to sell and deliver gas in accordance with the terms of the contract, he does have a remedy, to go to court on specific performance, or what-have-you, to get the producer to live up to the terms of the contract.

What this involves, whether this involves the

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prudent-operator rule, or whatever, that might be a defense the producer well might have.

Commissioner Smith: And I understand the producer's view of the obligation will be materially different, and will be decided on a case-by-case determination.

But your position, at least, is that this Commission also would have similar rights under the certificated contract to attempt to enforce it?

Mr. McGrath: Well, this is my personal view, Commissioner Smith:

When the Commission issues a certificate of public convenience and necessity to the producer, covering a particular sale, it authorizes that sale, as many of the old certificates would say, "all as more fully described in the application; and the application embodies the contract.

If the Commission has the right to compel a pipeline or natural gas company to live up to the term of a certificate, I would say yes, it has.

Those are my personal views. You may, of course, accept them for what they are worth.

Commissioner Holloman: You admit, or contend, that the Commission has the right to enforce its certificate and the underlying contract and its terms.

How, what additional obligations do our Orders 539 and 539-A impose other than that?

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Mr. McGrath: They impose a minimum daily delivery obligation which is not embraced or embodied in the contract and which is not contemplated by the parties. It is not really physically achievable.

Commissioner Smith: Would you object to 539 if it clearly did nothing more than make clear this issue upon which there has been disagreement between producers and pipelines expressed this morning, i.e., make clear that the Commission can and will enforce the provisions of the contract it certificates?

Mr. McGrath: As a statement of policy? I think that is what you are in effect saying. In the other sections of 2.83 which we think are unnecessary but if you wanted to state that as a policy and strike out 2.83(d), I think we would be—

Commissioner Smith: If this were reduced to that proposition, together with what minimum reporting requirements might be necessary, would that impose a non-price differential on the interstate-intrastate market which would be burdensome to the interstate pipelines for onshore supply?

Mr. McGrath: Well, I think it would, in the sense

that you are adding another area of uncertainty there and creating the specter of more government control as fas as producers are concerned, and they say "Well, we can sell our gas elsewhere, so why bother?"

Yes, I think it would. We do not favor 2.83 in any respect.

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Our real concern is Subsection (d); and the reporting requirements, any requirements there, we think would add a tremendous burden to the Commission's workload. One of our companies has 3000 wells to which it is connected. Are you going to require periodic reports and reserve redeterminations on 3000 wells, amendments, applications to amend certificates because of the declining ability of these wells to produce?

You are just inviting, if I may say so, a tremendous and unneeded workload, and the end result will be—what? The end result will not bring us any more gas. We are getting all the gas we can physically get from the wells, today.

And there is another aspect that we touched on in our comments. That is, it has been construed that this requirement would mean that although the pipelines are in a field where they could cut back their takes for a particular period of time they don't need the gas, because there is a minimum daily delivery obligation upon the producer to deliver the gas he is going to deliver it to the pipeline and the pipelines will have to take it and sell it somewhere, so it will be channeled into uses it would not otherwise serve or which would not be in the public interest.

This is not husbanding gas; this is promoting waste.

We just do not think this order is in the public interest. We urge the Commission to withdraw it in its entirety. But certainly we would urge that the Commission rescind paragraph, or

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subparagraph, 2.83(d).

I could continue, but Mr. Johnson and Mr. Gooch covered the various provisions of the contract on take-or-pay, or other items that I planned to discuss but which would further burden the Commission.

If there are no questions I yield.

Chairman Dunham: Thank you very much, Mr. McGrath.

The next witness represents Texas Eastern Transmission Corporation.

ORAL ARGUMENT OF

JAMES W. McCARTNEY

ON BEHALF OF TEXAS EASTERN TRANSMISSION CORPORATION and

TRANSWESTERN PIPELINE COMPANY

Mr. McCartney: May it please the Commission:

My name is James W. McCartney. I appear both for Texas Eastern Transmission Corporation and Transwestern Pipeline Company.

We are here to urge the Commission to rescind Section 2.83 and terminate the rulemaking.

We agree with the comments which have been made by Mr. McGrath.

We feel that 2.83 imposes an unreasonable burden, with absolutely no corresponding benefits.

Transwestern is a landlocked company. It has no access to the offshore area. Texas Eastern has.

It is particularly concerned about the impact the order will have on its very limited ability to compete for gas with the intrastate market.

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Fundamentally, we believe that these orders have their origin in mistaken assumptions: First, the mistaken assumption that the producers are withholding gas; secondly, the mistaken assumption that they have not been delivering all the gas required to be delivered by their contracts. For the last four or five years both Texas Eastern and Transwestern have been requesting from their producer-suppliers all the gas which they could make available; and we have no evidence that these suppliers have been withholding any gas or have not been fully living up to their contract commitments.

Our experience has been rather to the contrary, i.e., that the producers want to produce the gas and get it to market and sell it as fast as possible, and they are accelerating the depletion rates.

Now, we do want to distinguish one situation, and that is the pure warranty situation. Texas Eastern has a

warranty contract with Gulf pursuant to which Gulf is failing to meet its delivery obligation. But you can count these warranty contracts on the fingers of your left hand. The producers have all been burned by those contracts, and I think they have seen their day.

We are talking now about the thousands upon thousands of just standard-form gas purchase contracts.

The question was asked: How are these contracts negotiated?

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Well, I have before me contract forms for both Transwestern and for Texas Eastern. And what we do is start with a contract form, and no doubt the producer has in mind what he wants in the contract. We negotiate from that basis. What ultimately evolves is what the parties have agreed to and what the Commission ultimately considers and either approves in its certificate, or disapproves.

But it is important to note, and I think perhaps now there cannot be serious question, that the take-or-pay provisions, or the daily contract provisions, in the contract do not fix and were never intended to fix, and no party ever thought they would fix, the obligation of the producers to deliver gas.

In the first place, you have to remember that when these contracts are made 99 percent of the time the gas has just been discovered. As a matter of fact, the producer does not at that time know what he has. His geologist is essentially and by nature an optimist, because that is the only reason he is in that business, and—this is a fact, and I think history bears it out—it is a fact that

these reserves are overestimated originally. As production develops you see the natural decline, and you see what you have.

But the contracts are made at the outset and the producer does not know, the pipeline does not know; and therefore they contemplate and incorporate matters and terms dictated by the

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nature of the business; and this is the nature of the business. Furthermore, once you get into the operation the producer does not know what problems will arise on a day-to-day basis, and on a month-to-month basis, too, in many cases.

Therefore you have a very broad force majeure clause, to begin with.

I could talk for quite a while about all the unanticipated problems that arise. But the producers and the pipelines know there will be problems, and that is reflected in the contract. And the contracts provide that the production will be in accordance with good engineering practices, or no more than maximum efficient rate of flow, or various terms, incorporating basically the "prudent operator" concept.

Now, I understand how in some cases confusion can rise between the DCF, and what would be an obligation of the producer, because the contracts, if you read them only looking at the commitment paragraph, say that "the seller agrees to sell and the buyer agrees to buy" the daily contract quantity. But they say that, invariably, with

qualifying language, i.e., "subject to the other terms and provisions of this contract."

Therefore you have to look at the contract as a whole, to determine the obligations.

Commissioner Holloman: But you are saying that there is a daily contract quantity that the parties have agreed to,

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subject to the terms and qualifying conditions of the contract?

Mr. McCartney: Oh, yes. Sure. In some cases—well, the daily contract quantity is set out at the outset.

I have here a contract in which the daily contract quantity is stated to be 1 million cubic feet a day. But it is stated that it is "subject to the terms and provisions of the contract." And it is intended to fix the take-or-pay-for provisions which the buyer assumes.

As a general operating practice Transwestern and Texas Eastern have not called for reserve redetermination in many of their contracts for many years, because they knew the only result of a reserve redetermination will be to lower the daily contract quantity. The producer is ordinarily required to maintain certain deliverability. And we write letters, I have one here, in which we say "we have asked for all you can give us, and you have given us so much, therefore the daily contract quantity is reduced to 66 percent, "in the case of the producer's obligation to maintain 150 percent of capacity-or 80 percent.

But in case there is any doubt let me make it clear we do have an enforceable obligation. There may have been an implication that the producer had the absolute right to give us what we wanted to give us. That is not the fact.

The fact is that he has certain rights to operate his property in a reasonable and prudent manner, and some of the

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contracts say the deliveries and his method of operation will be in his discretion. But "discretion," according to all the cases, means "implied judgment." And "reasonably prudent operation" implies just that.

The producer cannot arbitrarily say "Well, today we have decided we will not give you the gas even though it is available.

If we ran into a situation like that we would move to enforce the contract and enjoin the producer or compel specific performance.

We clearly have that contract right. There is no question about that.

Discretion does not mean absolute arbitrary license.

Commissioner Smith: Has this Commission the right to do so in the event you declined?

Mr. McCartney: I know of no law on that. It would be our position, the position of Texas Eastern and Transwestern, that the Commission has the power to enforce contract obligations which have been certificated; how-

ever, certainly not to go beyond what is in the contract or what the producer has voluntarily and contractually agreed to do.

We certainly do not contend that the Commission can willynilly after the fact second-guess the producer or say "we really thought you meant to do" this or that, and then impose an obligation.

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But as far as I know, Your Honor, the answer to your question is that the courts have not spoken on that.

There are a couple problems with that: First, the determination of what is "reasonable and prudent". When the contract is made it is ordinarily is the standard of a "reasonably prudent operator," and is a factual determination by a court or jury; administrative determination looking to the public interest, perhaps, as distinguished from the legal standard of "prudent operation."

Secondly, I seriously doubt that the producer contemplated if some administrative body did not agree that he were operating reasonably and prudently, in the event of controversy, that they could subject him to fine and imprisonment, which is the sanction you have under the Act.

So there are problems associated with it, we realize, but we feel this Commission does have the authority to enforce its certificates which would embrace within those certificated rights the contract obligations the producer have assumed.

Let me say this: The pipelines maintain a close surveillance over these producers and their operations. We have reserve data, in the Reserve Department. We test data which they have to make and provide. We have performance data. We know and project in advance what gas will come from what sources. And we chart that.

Then we chart against that on a daily basis what actually does come from those sources. So we are able to pick up any

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discrepancies or anomalies in what we have projected and what has been delivered. This is what we have historically done.

By that means we are able to determine if there is any withholding, or any problem.

That is why I can tell you we have no evidence that the producer has withheld, nor indeed any evidence that the producers have failed to comply with their contract obligations.

Let me say in that respect, the pipeline has a substantial incentive to see that the producer lives up to his contract, because, as you well know, the pipeline's rates are based on assumed sales volume. It can only sell that gas if it can get it from that producer. It is frequently a main question, as in fact in recent settlement negotiations in which I was involved it was one of the main questions, that is, what is Transwestern going to be able to get from the producer. Our rates are based on contract rights, and whether we assume it will be received. If we do not get it and sell that volume we do not earn our allowed rate of return. You cannot have any greater incentive of a

pipeline to see that the contract obligations are met than that incentive.

We submit also that the producers have the incentive to maximize their cash flow. They have drainage problems. It is a rare case where you have a producer who totally controls a supply source. They are trying to get all the gas they can out of that source, and trying to drain that other fellow, and he is trying to drain them. And that keeps them

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honest in this respect.

So you can be assured if there is any chance whatsoever that they will be drained they are going to push that delivery to the hilt.

That ignores the further fact that they have these problems with their royalty owners; they have obligations under their leases to diligently develop and market. And this is an implied obligation in these onshore leases.

Offshore you have a stack of regulations that thick (indicating), as Your Honors know, that control the operations of the producers. So they have their incentives. The pipelines have their incentives. And we are satisfied that they are performing.

Basically, here is why we oppose this section which the Commission has promulgated: We think it is a disincentive, and we think it will deter commitment of exploration dollars. And we feel it does so with absolutely no corresponding benefits. It is difficult enough for a producer to risk exploration dollars and commit his funds

and find gas, without somewhere down the line someone saying "Well, you did not find enough." And that is essentially the problem they will be looking at.

Your Honors have said that "we really do not mean there is any certificated volume, if it is not imposed by the contract." But when you read the language of this Order 539-A, it simply

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refers to "the certificated minimum daily delivery obligation." And when the producer sees that he thinks it means "the certificated minimum daily delivery obligation." And this causes, as you can see, serious problems.

Now thirdly, we feel that as a practical matter you will achieve nothing, since all the producers are going to do is to reject these contracts and say "We do not agree to deliver one mcf." They will make these contracts so clear that there is no delivery obligation that the purpose will have been defeated and you will have produced a counterproductive order.

You say you are rulemaking for the future. If you were a producer and did not understand the order and did not know what you had, you would do everything you could to eliminate any question that you were incurring an obligation which you do not voluntarily incur.

Finally, as a practical matter, as has been pointed out this Commission cannot enforce and cannot police these thousands upon thousands of wells.

Let me say this: If the Commission entertains some doubt — frankly, we entertain no doubt, and recommend

it be obliterated—if the Commission feels the necessity to do something, consideration could be given to a spot-check within the limits of your staff's capability, and a filing, perhaps, of a show-cause order on the basis of a complaint,

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or on the basis of information that the Commission has developed.

But certainly what you have done here is to prescribe a cure which has very, very serious side effects; you have given us a pill that has tremendous side effects, for an illness which does not exist. So let us determine first that the illness exists. Then, let us address the illness itself. But do not burden the entire industry with a provision, or with provisions, in an order which we feel, and I think demonstrably so, offer no benefits, but only very serious burdens and risks.

Thank you.

Chairman Dunham: The Chair thanks you for your clarity.

Mr. McCartney: Thank you, sir.

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initial unproved estimates which are not yet proved production, and are typically high, based on deliverability forecasts which may state something through the anticipated life of production but which invariably turn out to be way off the mark and perhaps based on misreadings and misapplications of contracts as a whole, in picking some daily contract quantity or take or pay quantity out of context and saying that is what you have to produce forever—now, tomorrow and the next year, and you have to make the investment to do it.

That sort of thinking has driven us to what I consider real extremes in turning down a massive scale, for Continental all the certificates. Most of the other producers have been turning them down en masse.

I think basically 539 and 539-A are not necessary. If it were just a sample statement that contract or certificate obligations would be enforced, I would have no problem. But it goes beyond that, and that is the trouble I have.

Commissioner Smith: If that had been the position taken by the Commission, that it was making itself a party, for enforcement purposes, to the contract it certificated, to the extent that that signaled the "prudent operator" judgments a producer made would be subject to examination would that not be the kind of

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future surveillance or uncertainty you find objectionable? Or would you assume it would be administered in a reasonable fashion?

Mr. Burton: I like to think it would be done in a reasonable fashion.

It would still lead to some lack of definiteness, since you would not know what you would be held to in the

future by a test not even contemplated by the contract and, secondly, applied in an administrative proceeding where I would have concern about the overall balance of judgment that would result from trying to delve into these areas which are so intricately part of production, and laying aside the production exclusions as to jurisdiction, which are so fundamentally matters I think not properly within the Commission's expertise, and which would call for a myriad of individual proceedings.

The Commission had gone away from these massive proceedings on rates, nearly 20 years ago, because of the disasters from trying to have massive determinations.

I think you would see a quagmire of 10 to 100 times the magnitude of what would have been the individual rate case debacle if it had persisted. You would have everybody in all of the time and we would not be able to get our business done; we would have no confidence or any way to make sound business judgments on a prudent basis,

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because we would not know what our expenditures or investment or timing of development would have to be. We would be vulnerable to determinations outside the contract framework.

If 539-A were written to say it is contract obligations and they will be enforced, I would not have the problem.

I see I have overrun my time. I think other counsel covered the other basic points I felt it was necessary to bring up today.

The Chairman: Thank you, Mr. Burton.

Mr. Johnson, I believe you have reserved time for rebuttal?

Mr. Johnson: I would like to focus this portion of my argument on the policy questions involved in adoption of 539 and 539A.

REBUTTAL ARGUMENT OF
THOMAS G. JOHNSON
ON BEHALF OF
SHELL OIL COMPANY

Mr. Johnson: I think we have beaten the legal issues to death.

I would like now to share with Mr Simons a moment of nostalgia because I can recall many arguments before this Commission when Mr. Simons assured the Commission there was no shortage of natural gas, there would never be any, that it was a figment of the producers' imaginations.

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At that time we tried to tell the Commission if they did not allow cost of replacing the gas there would be a shortage. That shortage is upon us. Mr. Simons and Mr. Wheatley cannot deny it. Now they are saying the shortage is here because the producer withholds gas. They do not quite say that. They say the shortage is here and we don't know the reason, but we suspect producers are withholding gas because we think they have an incentive

to withhold gas because of the deregulation argument going on in Congress.

This morning, I tried to suggest there are many reasons producers have incentives not to withhold gas. Our obligations to the lessor, the fact we are drained by the neighboring lessee, if we do this, many other reasons, the fact we are violating state law, many strong reasons not to withhold gas, even if we chose to do so

One of the big reasons is we get no money until we sell gas and we have heavy front-end investments on which we have to get a return on, and get a return of these investments. All these, though, are factual questions.

I think what shocked me the most this morning was the contention proposed, I think by Mr. Wheatley, some of the producers are somehow charged with the estimate made by the pipeline at the time the initial pipeline certificate was issued, as to what the deliverability and

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reserves might be, and that if the producer disagreed with that estimate they could tell the Commission at that time.

First of all, Mr. Wheatley very carefully and deliberately slides from an estimate to a requirement. I think that is the key to this whole problem. Estimates are estimates, and they are very, very, very rough estimates at the time production initially begins.

If Your Honors have any doubt about it, our recommendation to you is to reopen the hearing in the Natural Gas Pipeline case and let us present evidence—we have filed ours already in spite of the Commission's last minute

order saying we did not have to—and we think we can prove to you that these estimates are very, very rough. There are many, many unknowns in connection with producing a reservoir. And nobody really knows the answers.

We have estimates, the pipelines have estimates. But estimates is all they are.

We submit if this Commission tries to turn those estimates around into a requirement for service, they are requiring producers to do something we cannot do, no matter what you do. We cannot make that reservoir—the estimate is made at the top of that curve, and there is no way we can make this reservoir which is now down at this stage of completion come back up here. We cannot do it. No matter how many proceedings you have, we still

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cannot do it.

The problem is that we are not committing to a service continuing without limitation until the Commission says differently. And that is another key to the problem. The first key is the question of what the producer's obligations are. We have discussed that at length already.

The second question is, from the standpoint of what evidence is required, and we are trying to make the Commission see if you have a requirement that says the producer has the burden of proof, if he cannot meet a specific level to come in and prove to you why, then you have a requirement that there be a case like this for every gas field and every reservoir in the United States, at some point in time, and the magnitude of those proceedings

boggles the mind. You would have to at least quadruple your staff and requires tremendous resources for the producers to come in and prove we are not guilty of something no one ever proved we are guilty.

What Mr. McCartney said, I suggest it is worthy of the Commission's consideration, is to put the burden on the other side. If someone has reason to believe in a specific field a producer is withholding gas, let him file a complaint with this Commission and prove it. The Commission has a staff to audit data. It can find out whether or not that is right and do it on a rightful basis instead of

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using an atomic bomb to kill a flea.

The other point is this: if the Commission is concerned on a massive scale about gas being withheld, you have plenty of means to investigate that. You are investigating, you have investigated it, I am sure you will continue to do so. You have Form 40. In the South Louisiana case the staff made audits. It had the Natural Gas surveys; there have been all sorts of investigations of the industry. And no one can nail down these reserves under the ground. No one can get down 51 miles and see what is there. We can never prove this goblin does not exist and Mr. Wheatley and Mr. Simons insist we must do so.

I think the problem is quite simple: the Commission is urged to impose obligations here which nobody in this world can meet. That is the basic problem we have with it.

Now, I would like to focus on some things that were

said directly. Mr. Simons mentioned the Transco investigation. I would like to refer to the staff report in this case, docket RP75-1, which was ordered placed in the Public Reference Room by this Commission on December 5, and what the Commission staff found upon investigation and audit was this:

Based on the areas investigated the technical staff has not found any evidence of shutin reserves being withheld from the market or that there are wells capable

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of delivering this excess of current levels which can be legally or in some cases, economically produced."

It goes on, "the conclusion of the technical staff based on the investigation just completed that further inquiry along the aforementioned approach will not turn up any effort or conspiracy on the part of the producer-sellers to withhold or conceal volumes of presently deliverable natural gas from the market. Any conspiracy at the level at which technical staff investigated would necessarily involve thousands of people and an attempt to cover up such an action would surely fail. The current investigation was sufficient to uncover anything about anything, although it may not have covered everything."

Now, we are trying to use our resources to find more gas. If we have to dedicate our reservoir engineers to defend these proceedings before this Commission as to why our fields are depleting, they will not have time to do anything else, and that is the problem we would face.

Commissioner Holloman asked a question about the order and what it provided in excess of the contract require-

ments. I would like to read from page 13, the provisions of proposed Section 2.38(d): "The certificated minimum delivery obligation of the seller shall be determined in accordance with the applicable provisions specifically set forth in the seller's contract unless

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otherwise changed by certificate authorization."

Obviously, we read that this will be a change and a requirement. "Shall be without regard to any contractural reservations contrary to the subject authorization."

That means if we write in the contract there is no requirement, you will tell us there is one. That is the only way we can read it.

We think this is doing just what the pipeline have told you, by requiring producers to undertake an obligation which we cannot even at the moment define, this will drive the producers out of the business literally, the little ones and will attempt to make the people who try to invest in finding gas try to do something else. Because we have an obligation here we cannot even measure, and that is the problem.

I think that is all I have. I wanted to check my notes just a moment to see if there is any question I have overlooked.

I believe not.

Does the Commission have any questions?

The Chairman: Do you have any questions?

Commissioner Watt: Are there further witnesses?

The Chairman: I believe there are a couple more.

Mr. Gooch?

Mr. Gooch: I defer to Mr. Wheatley.

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process. But we think the Commission not only has to enforce the existing contracts to the extent that they are clearly delineated, but it should also where there is an area of not clear delineation, should refer to the certificate as setting the basic standard and put the burden then on the producer to say why that certificate standard cannot be met.

Thank you.

The Chairman: Thank you, Mr. Wheatley.

Mr. Johnson: May I respond very briefly to Mr. Wheatley.

Mr. Chairman, I think Mr. Wheatley has erroneously stated some of the procedure involved in a pipeline certificate proceeding, in that he indicated the producers gave estimates of their reserves. My understanding of what happens is that the producers provide all their basic data to the pipeline companies and the pipeline companies then make their own estimate of reserves. Those estimates are audited and examined by the Commission Staff.

The producers do not make any representations to the pipeline or to the Commission of what the reserves are.

Secondly, I think Mr. Wheatley has left an impression that there is a pipeline connected to one field and if there is some error in the reserve estimate for that

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field that affects the entire deliverability of the pipeline.

As I think Commissioner Smith indicated by his questions, obviously that is not the situation with which the Commission deals. It deals with the major interstate pipelines, which are connected to many fields.

As Mr. McGrath made clear the deliverability of that pipeline depends on many things, not just one producer in one field. How the pipeline juggles that delivery between fields or between storage or between line-pack is the pipeline's business. There is no connection between the deliverability requirement of a pipeline and any obligation on the producer to deliver anything.

Finally, Commissioner Smith asked how we could get to a base level. And that is the real problem. There is no way you can do it, because you have a sliding scale and you don't know at what point on that slide you are. We don't know, the Commission does not know, and after 1000 proceedings you still will not know, because you are always sliding down the slide, and at any one given time you are at a different point on the slide than you were the day before.

That is why Mr. Wheatley's insistence that there be a level and we must prove we are not committing

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a crime when the level changes, just will not work. It is like saying to the weather man you take all your scientific devices, and you tell me whether it is going to rain tomorrow, and he does, he makes an estimate. Are you going to jail him if it rains tomorrow and he says it won't? That is what we are dealing with, we are dealing with an estimate.

I want to say one or two more things.

In 1974 according to the reserve figures this industry was producing every year one-tenth of proved reserves, compared to one-twenty-fourth of proved reserves in 1960. I think that is concrete evidence. This Commission can develop all of the evidence it needs without providing for a proceeding and every reservoir as to whether or not there is some massive withholding going on. If you are concerned about specific situations let there be an investigation of the specific situation, or let someone file a complaint. You have monitoring devices, you have the forms you require. Your Staff can tell whether there is a serious problem. You don't have to impose this obligation on every field in the country in order to determine whether in a specific instance a producer is withholding gas.

Thank you.

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The Chairman: Are there any others?

Mr. McCartney.

Mr. McCartney: I have no more argument, Your Honor, just some facts.

Commissioner Watt: Does that mean what you said before was not factual.

Mr. McCartney: I should not have said that, Your Honor.

Your regulations in connection with pipeline certificate cases provide a definition for deliverability which you should refer to and specifically state that deliverability as the term is used within those regulations shall be governed by the physical capabilities of the sources to deliver gas and by the term of existing gas purchase contracts, and by limitations imposed by state or Federal regulatory agencies.

So the limitations in the contracts are necessarily taken into consideration when pipeline certificates are considered and issued.

An interesting fact that occurs to me as we discuss the validity of estimates: Transwestern Pipeline Company in 1961 began a series of hotly contested certificate proceedings in which the principal issue or one of the principal issues was the sufficiency of its gas reserves. And literally in the Rock Springs case

[145]

in G-16235, the Gulf Pacific case which followed, the two Cities Service cases which followed, and which covered a period of four to five years of continuous hearing,

virtually every grain of sand was counted in Transwestern's contract reserves, by this Commission, by its adversaries, by its expert witnesses. It was gone over time and time again through the hearing process.

Yet today those reserves are still being reviewed and those estimates are still being changed and corrected as experience reflects that they were inaccurate in the past.

Finally, I want to simply respond to Mr. Simons' statement that there has been no understanding to enforce the Gulf warranty. That is not the case. That matter is pending before an Administrative Law Judge. It will be before you in due course. However, Texas Eastern has filed suit in District Court in Harris County to protect and guarantee the contract obligation of Gulf, and it is pursuing a course of enforcement as the record in this case will reflect.

Thank you.

The Chairman: Mr. McGrath or Mr. Burton?

Mr. Burton: Thank you, Your Honor. I think this is a good time to cut it off.

Mr. McGrath: I think we have covered it.

* * *

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

[Title omitted in printing]

Reference to Order No. 539-B of the
Federal Power Commission

(Dated July 30, 1976)

The order of the Federal Power Commission in this case has been reproduced as Appendix C in the Petition for a Writ of Certiorari No. 77-1652, *Federal Energy Regulatory Commission* v. *Shell Oil Company, et al.*, and as Appendix B in the Petition for a Writ of Certiorari No. 77-1654, *Consumer Federation of America, Energy Policy Task Force* v. *Federal Energy Regulatory Commission.*

[1]

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: John H. Holloman III, Acting Chairman; Don S. Smith, and James G. Watt.

Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Service Under Certificated Arrangements	))))	Docket No. RM76-8

ORDER DECLARING PETITIONS FOR REHEARING MOOT

(Issued September 13, 1976)

On July 30, 1976, the Commission issued Order No. 539-B, *Order Clarifying Prior Orders And Amending Section 157 Of The Commission's Regulations Under The Natural Gas Act,* Docket No. RM76-8. On August 24, 1976, Pennzoil Company, Pennzoil Producing Company, Pennzoil Offshore Gas Operators, Inc., and Pennzoil Louisiana and Texas Offshore, Inc. (Pennzoil) filed a joint "protective" application for rehearing of Order No. 539-B. An identical application has been filed by Tenneco Oil Company (Tenneco Oil) and Tenneco Exploration, Ltd. (Tenneco Exploration). Applicants assert that since Order No. 539-B was issued in response to petitions for rehearing of Order No. 539,[1] it is a final order that may

1. Order No. 539-A, *Order Granting In Part And Denying In Part Reconsideration, Clarifying Order No. 539, Denying Stay, Noticing Of Oral Argument And Granting Intervention,* Docket No. RM76-8, ____FPC____ (March 26, 1976).

be appealed to the courts immediately without further application to the Commission for rehearing, but in order to protect themselves should

[2]

this supposition be incorrect, applicants have filed applications for rehearing of Order No. 539-B.

Applicants' assumption that Order No. 539-B was the final order to be issued in the Docket No. RM76-8 proceeding is correct. The Commission considered Order No. 539-B ripe for appellate review under Section 19(b) of the Natural Gas Act as of the date of issuance, as did several other parties that have petitioned for such review in *Shell Oil Company v. Federal Power Commission*, No. 76-3066 (5th Cir.).[2] Therefore, the "protective" applications for rehearing filed by Pennzoil, Tenneco Oil and Tenneco Exploration are moot.

Three other parties have filed late applications for rehearing. The Offshore Company (Offshore) and Sonat Exploration Company (Sonat) filed separate petitions for leave to intervene late and applications for rehearing by way of reconsideration. Both companies assert various reasons for their opposition to the prudent operator standard promulgated in Order No. 539-B, such as the vagueness of the test and the lack of Commission jurisdiction to impose such a condition. The issues raised by Offshore and Sonat in their applications for reconsideration were adequately addressed and disposed of in Order No. 539-B.

2. In addition to Shell, other petitions for court review have been filed by General American Oil Company of Texas, Placid Oil Company, and Skelly Oil Company.

Accordingly, the Offshore and Sonat filings, like those of Pennzoil, Tenneco Exploration and Tenneco Oil, are declared moot, but the Commission will permit the requested intervention of these two parties in the proceeding.

The remaining application was filed by the Consumer Federation of America (CFA), which requests that the Commission withdraw Order No. 539-B, including now rescinded Section 2.83(d) of the Commission's Regulations. For the reasons expressed earlier, the CFR application is also moot.

[3]

The Commission orders:

(A) The applications for rehearing of Order No. 539-B filed by Pennzoil, Tenneco Oil, Tenneco Exploration, Offshore, Sonat, CFA, and all other such applications for rehearing or reconsideration of Order No. 539-B filed in this docket, are declared moot for the reason that said order was the final order within the meaning of Section 19(b) of the Natural Gas Act and was, therefore, immediately subject to judicial review without further action by this Commission.

(B) Offshore and Sonat are permitted to intervene in this proceeding subject to the Rules and Regulations of the Commission; *Provided, however,* that the participation of such intervenors shall be limited to matters affecting asserted rights and interests as specifically set forth in their petitions to intervene; and *Provided, further,* that the admission of such intervenors shall not be construed as recognition by the Commission that the parties might

be aggrieved because of any order or orders of the Commission entered in these proceedings, and that the intervenors agree to accept the record as it now stands.

By the Commission.

(S E A L)

KENNETH F. PLUMB,
Secretary.

FEDERAL POWER COMMISSION

Washington, D.C. 20426

September 28, 1976

Mr. Gilbert Ganucheau
Deputy Clerk
United States Court of Appeals
for the Fifth Circuit
600 Camp Street
New Orleans, Louisiana 70130

RE. *Shell Oil Company v. Federal Power Commission*, 5th Circuit No. 76-3066

Dead Mr. Ganucheau:

This will confirm my conversation of September 23, 1976 with you respecting the motion of Shell Oil Company for enlargement of the certificate of record in lieu of record.

1. Shell and the Commission had agreed that the Court should not take any action on Shell's motion, unless requested by either party.

2. The Commission has affirmed its understanding that the disposition of this appeal will govern the validity of the Commission's Section 157.41 condition for certificates in each case in which the Commission has imposed that condition including, without limitation, the certificate which Shell has sought in FPC Docket Nos. CI76-225, CI76-3 and CI-196.

3. The Commission will supplement the record in this proceeding with Commission orders in *Natural Gas Pipeline Company of America, et al.*, Docket Nos. CP76-14, *et al.*, issued November 21, 1975, January 26, 1976, February 12, 1976, February 13, 1976, March 19, 1976 and March 24, 1976.

Very truly yours,

ALLAN ABBOT TUTTLE
Allan Abbot Tuttle
Solicitor

cc: all parties

[1]

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Richard L. Dunham, Chairman; William L. Springer, Don S. Smith, and John H. Holloman III.

	Docket Nos.
Natural Gas Pipeline Company of America	CP76- 14
Tennessee Gas Pipeline Company	CP75-301
Kerr-McGee Corporation	CI76- 6
Cabot Corporation	CI76- 95
Skelly Oil Company	CI76-109
Aztec Oil and Gas Company	CI76-121
The California Company, a Division of Chevron Oil Company	CI76-122
General American Oil Co. of Texas	CI76-142
Union Texas Petroleum, a Division of Allied Chemical Corporation	CI76-161
Ocean Production Company, *et al.*	CI76-184
Phillips Petroleum Company	CI76-218
Kerr-McGee Corporation	CI76-238
Cabot Corporation	CI76-260
Felmont Oil Corporation	CI76-265
Case-Pomeroy Oil Corporation	CI76-266
Mobil Oil Corporation	CI75-538
Valhi Inc.	CS76-165
Dalco Oil Company	CS66- 96
Texasgulf, Inc.	CS71-383

FINDINGS AND ORDER GRANTING TEMPORARY AND PERMANENT CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY AFTER STATUTORY HEARING AMENDING PRIOR ORDER, SETTING HEARING, CONSOLIDATING PROCEEDINGS, GRANTING INTERVENTIONS, ACCEPTING RATE SCHEDULES FOR FILING, AND REJECTING NOTICE OF WITHDRAWAL

(Issued November 21, 1975)

On October 17, 1975, in Docket No. CP76-14, Natural Gas Pipeline Company of America (Natural) filed a petition for reconsideration of the Commission's letter-order dated

[2]

October 14 which denied Natural's request for temporary certificate to construct its pipeline project.[1] On July 14, 1975, Natural filed its application pursuant to Section 7(c) of the Natural Gas Act for authorization to construct and operate 9.6 miles of 16-inch OD pipeline in the South Addition, West Cameron Area of offshore Louisiana. The proposed facilities will extend from Block 543 to a point of interconnection with Stingray Pipeline Company's (Stingray) existing 30-inch OD facilities in Block 565 of the same area. Stingray would then transport the gas onshore through its present system and re-

1. Natural's filing is not properly a petition for rehearing under Section 19 of the Act as the order of October 14, is not a final order of the Commission. Natural's filing will be treated as a motion for reconsideration.

deliver an equivalent volume to Natural near its onshore station, where Natural has pipeline facilities, located in Cameron Parish, Louisiana.

Stingray would transport the gas under its present Rate Schedule T-1. Natural states that it will transport for its self and/or others approximately 78,000 Mcf/d in the first year. The line is designed to transport 165,000 Mcf/d. Total cost of the proposed facilities is estimated to be $5,658,000. Natural has a contract to purchase gas from Kerr-McGee Corporation (K-M) from Block 543, West Cameron.

By a motion filed September 14, 1975, Natural requested temporary authorization to construct but not operate the proposed facilities. Natural estimates construction time to be about 30 days assuming normal fall weather. Natural stated that Northern Natural Gas Company (Northern) and Columbia Gulf Transmission Corporation (Columbia Gulf) are negotiating for the remaining 50 percent of the reserves on Block 543—25 percent to each company—and have indicated their desires to have Natural transport their gas from the said block as well as gas from Block 544 of the same area. Natural requested a waiver of Section 2.65(a)(4) which requires the utilization of a load factor of 60 percent for rate making purposes. At the initial transportation volume of 78,000 Mcf/d the load factor would be 46 percent, therefore, below that required by the aforementioned section. However, Natural expects additional gas to become available for purchase or transportation.

[3]

By letter-order dated October 14, 1975, the Commis-

sion denied Natural's Motion because all interdependent applications had not been filed. Natural now seeks reconsideration and states that 30,000 to 35,000 Mcf/d of gas would be available from K-M's 50 percent interest in Block 543 of a total 90,000 to 100,000 Mcf/d from the Block 543 Field, which includes adjacent Blocks 544 and 522. The ownership of the Block 543 Field is as follows: In Block 543; Kerr-McGee (K-M) 50 percent; Cabot Corporation (Cabot) 25 percent; and Felmont Oil Corporation and Case-Pomeroy Oil Corporation (Felmont) 25 percent. In Block 544, a 25 percent interest is owned each by Phillips Petroleum Company (Phillips), Skelly Oil Company (Skelly), Union Texas Petroleum, and Texas Gulf Inc. (Texas Gulf). In Block 522, K-M, Cabot and Felmont own producing rights pursuant to a farm-out agreement from the SLAM Group. Felmont has not filed to sell gas from its 25 percent interest in Block 543.

Natural submits that sufficient compliance has been made as to the interdependent applications of natural gas producers and transportation agreements and that waiver of the regulation by the Commission should be permitted as in *Texas Eastern Transmission Corporation, et al.*, Docket Nos. CP63-177, *et al.*, order issued July 18, 1975. Natural notes that in the offshore Project 281, Texaco had not filed for appropriate Commission authorization and that the Commission subsequently granted a temporary certificate to construct and operate Project 281, conditioned on producer authorizations to sell gas. In view of the substantial number of producer filings which are now before the Commission for concurrent action on a project basis, there appears to be available a sufficient supply of natural gas to support the grant

of a certificate to Natural as will hereinafter be ordered, consistent with the Commission's prior action set forth in *Texas Eastern, supra.*

Kerr-McGee Corporation (K-M) requests a permanent certificate in Docket No. CI76-6 to initiate sales of gas to Natural Gas Pipeline Company from its 50 percent working interest in Block 543, West Cameron Area, offshore Louisiana Federal Domain, at the national rate established in Opinion No. 699-H (51.0¢ per Mcf at 14.73 psia subject to upward and downward Btu adjustment from a base of 1,000 and a gathering allowance of 0.5¢ per Mcf in lieu of the base contract rate of $1.44 per Mcf (15.025 psia).

[4]

Cabot Corporation (Cabot) requests a permanent certificate in Docket No. CI76-95 to initiate sales of gas from its 25 percent working interest in West Cameron Block 543 to Northern Natural Gas Company (Northern) at the national rate in lieu of the base contract rate of $1.40 per Mcf (14.65 psia). The remaining 25 percent working interest in West Cameron Block 543 is owned by Felmont Oil Corporation and Case-Pomeroy Oil Corporation (Felmont). To date, neither Felmont nor Case-Pomeroy has filed for authorization to make sales from their working interest.

Skelly Oil Company (Skelly) requests a temporary certificate in Docket No. CI76-109 and Union Texas Petroleum, A Division of Allied Chemical Corporation (Union Texas) and Phillips Petroleum Company (Phillips) request permanent certificates in Docket Nos. CI76-

161 and CI76-218, respectively, to initiate sales of gas from Block 544, West Cameron Area, offshore Louisiana Federal Domain, to Columbia Gas Transmission Corporation (Columbia) at the national rate in lieu of the base contract rate of $1.05 (15.025 psia). Skelly, Phillips and Union Texas each own a 25 percent working interest in Block 544. The remaining 25 percent working interest is owned by Texasgulf, Inc., holder of a small producer certificate in Docket No. CS71-383. Texasgulf's interest is dedicated to a contract with Columbia.

The contracts submitted by Skelly, Union Texas and Phillips limit the dedication to gas produced from the Lent 1 Sand and provide that upon written notice to the buyer, sellers may exercise an option to receive up to 25 percent of the average daily quantity of gas produced. The contract submitted by Cabot provides that Cabot has the right, upon 6 months written notice to the buyer, to have up to 20 percent of the gas returned to Cabot at an onshore point in South Louisiana. K-M's contract limits the dedication to all depths down to a true vertical depth of 12,305 feet, provides for a term of 15 years and permits K-M to withdraw for its own use up to 25 percent of the gas upon at least 6 months prior written notice to Natural.

[5]

By telegram filed October 15, 1975, K-M advised that it would amend its contract to relinquish its option to reserve gas and to extend the term from 15 to 20 years if the following occur on or before November 13, 1975: (1) The issuance of a permanent certificate to Natural to construct and operate its proposed facilities; (2) The

issuance of a permanent certificate to K-M for its proposed sale; and (3) The construction of Natural's proposed facilities. In addition, K-M's contract provides that Natural will transport liquids for K-M free of charge unless Natural is required to allocate and bear costs for such liquid transportation or pay third parties for such liquid transportation. Cabot's contract provides that Cabot will pay Northern 20.0 cents per barrel for transporting or causing the transportation of liquids for Cabot.

K-M on October 28, 1975, in Docket No. CI76-238 filed an application for a certificate for the sale of gas from Block 522 of the Block 543 Field, West Cameron Area, Offshore Louisiana, in the Federal Domain. K-M proposes to initiate the sale of gas to Texas Eastern Transmission Corporation (Texas Eastern) from its interest in Block 522 at the national rate established in Opinion No. 699-H, in lieu of the contract rate of $1.44 per Mcf. K-M's contract provides for a term of 20-years and commits all gas produced from the surface down to the base of the deepest hydrocarbon bearing reservoir or its correlative zone encountered as of the contract date. The leasehold interest in Block 522 owned by SLAM (Burmah Oil and Gas Company, Louisiana Land and Exploration Company, Amerada Hess Corporation and Marathon Oil Company, hereinafter Burmah, *et al.*) was farmed out to K-M, Cabot and Felmont. Cabot in Docket No. CI76-260, Felmont in Docket No. CI76-265 and C-P in Docket No. CI76-266 have filed application to sell the other 50 percent farmout interest in Block 522 to Texas Eastern on the same basis as set forth above in K-M's sale. In view of the lack of notice of the applications and opportunity for protest and intervention, the

Commission will grant K-M, Cabot, Felmont and C-P temporary certificates.

Natural has made advance payments to K-M; Columbia has made advance payments to Phillips, Skelly and Union Texas; and Northern Natural has made advance payments to Cabot.

[6]

Tennessee Gas Pipeline (TGP) proposes in CP75-301 to construct and operate 33.7 miles of offshore transmission pipeline, and related facilities, extending from a production platform of Chevron Oil Company in Block 249, South Marsh Island area, offshore Louisiana, Federal Domain, northwesterly to a point of connection onshore with the Pecan Island processing plant, Vermilion Parish, Louisiana, and then to the Blue Water Project pipeline system jointly owned by Tennessee and Columbia Gulf Transmission Company. Tennessee will receive and transport to its mainline system, volumes of gas to be purchased from Chevron and other producers in Blocks 249 and 250, South Marsh Island area offshore Louisiana. Tennessee has made advance payments of $55 million covering the South Marsh Island area, Blocks 249 and 250, with each of several producers owning interests therein.

The California Company, a Division of Chevron Oil Company, (Chevron) and General American Oil Company of Texas (GAOCT) request permanent certificates in Docket Nos. CI76-122 and CI76-142, respectively, and Aztec Oil & Gas Company (Aztec) and Ocean Production Company, *et al.* (Ocean), (the *"et al."* parties are Ocean

Oil & Gas Company and Murphy Oil Corporation) request temporary certificates in Docket Nos. CI76-121 and CI76-184, respectively, to initiate sales of gas to Tennessee from Blocks 249 and 250, South Marsh Island Area, offshore Louisiana (Federal Domain) at the national rate established in Opinion No. 699-H (51.0¢ per Mcf at 14.73 psia subject to upward and downward Btu adjustment from a base of 1,000 and a gathering allowance of 0.5¢ per Mcf) in lieu of the contract rates of $1.63 (15.025 psia). Each related contract dedicates only those reserves found in specified reservoirs. In addition, the contracts submitted by Chevron, Ocean and GAOCT also permit the reservation of a portion of the gas in the dedicated reservoirs for the producer's own use. Ocean has not reserved gas for its own use. Murphy Oil Corporation, an *"et al."* party to Ocean's application, has reserved gas for its own use. Chevron's contract with TGP is for a term of 10 years and year to year thereafter unless cancelled by either party and the contracts submitted by Aztec, GAOCT and Ocean provide for a primary term of 10-years and year-to-year thereafter unless cancelled by either party, although it is understood that TGP has a continuing right to purchase gas for 20-years.

[7]

The advance payment agreement with Chevron provides that the contract term will be 20-years and the advance payment agreements with Aztec, GAOCT and Ocean provide that the contract term will be 20-years unless the Commission is currently accepting contracts with lesser terms but in any event, not less than five years. In the

event Chevron, Aztec, GAOCT and Ocean accept temporary certificates and have their applications set for hearing as hereafter scheduled, they shall show cause by their evidence why the term of their contracts should not be amended to be equivalent to the term prescribed (20 years) in its advance payment agreements.

Chevron's July 24, 1975, contract dedicates only 75 percent of the reserves in the specified reservoirs; the remaining 25 percent has been reserved by Chevron for its own use. GAOCT has reserved the right to reserve a total volume of 25,550,000 Mcf for its own use from various blocks (South Marsh Island Blocks 170, 249, 250, and 258 and East Cameron Block 251) subject to advance payment agreements with Tennessee; provided such volume does not exceed 20 percent of the total recoverable reserves attributable to GAOCT's interest in such blocks. Murphy has reserved the right to reserve 54,750,000 Mcf for its own use from various blocks (South Marsh Island Blocks 170, 249, 250, and 258; East Cameron Block 351; and West Delta Block 124) subject to advance payment agreements with Tennessee, provided such volume doesn't exceed 20 percent of Murphy's interest in the recoverable reserves underlying such blocks.

The subject application with TGP cover 77.5 percent of the working interests in Block 249 and 70.0 percent of the working interests in Block 250. The Superior Oil Company and Canadian Superior Oil (U.S.) Company own a 13.0 percent and 7 percent working interest, respectively, in Blocks 249 and 250. No application has been received from either producer. Dalco Oil Company owns the remaining 2.5 percent working interest in Block

249 and a 2.0 percent working interest in Block 250; Dalco has a small producer certificate in Docket No. CS66-96. Its interest is committed by contract to TGP. The remaining 8.0 percent working interest in Block 250 is owned by Valhi, Incorporated. On September 24, 1975, Valhi filed for a small producer certificate in Docket No. CS76-165. TGP has filed a contract for Valhi's sale.

[8]

A parallel situation involves the TGP Project Block 249, South Marsh Island, as Natural's Block 543 project previously described and the Commission will extend the same treatment to Tennessee's project and issue it a similar certificate.

The contracts submitted by GAOCT and Aztec contain the following provision:

> If at any time, and from time to time, after the date of this Agreement the price per Mcf authorized to be paid by Buyer for gas purchased from any gas producer whomsoever in fields located within the Southern Louisiana and Offshore Area shall be greater than the price per Mcf of gas purchased under this Agreement, Buyer will increase the price per Mcf payable to Seller for gas delivered under this Agreement to equal such higher price.

Such provision constitutes a favored-nation clause which is impermissible in contracts dated after April 3, 1961, pursuant to Section 154.93 of the regulations. The authorization granted herein to GAOCT and Aztec, either temporary or permanent, is conditioned on removal of said provision within 30 days herefrom.

Chevron's contract provides that Tennessee will transport liquids for Chevron and charge the rate prescribed by any FPC order for such transportation service. The contracts submitted by Aztec, Ocean and GAOCT also provide that Tennessee will transport liquids for the producers at no charge unless the FPC requires that a transportation charge be paid. TGP, Natural and Stingray will be directed to file a liquids transportation rate schedule 30 days prior to initiation of said service for natural gas producers, together with a supporting cost of service exhibit, as a condition to issuance of a certificate.

This order involves thre separate and distinct pipeline projects in the Gulf of Mexico, offshore Louisiana in the Federal Domain wherein interstate pipeline companies subject to the jurisdiction of the Commission under the Natural Gas Act seek to attach new supplies of natural gas to be produced from Federal leases owned by natural gas producers. Natural gas producers seek Commission approval of contracts which limit the dedication of gas to specified producing formations, reserve specific portions of gas

[9]

for their own use, or limit the sale of gas to specified percentages of available reserves and limit the term of their contracts for the sale of gas. In view of the national shortage of natural gas and the declining gas reserves of interstate pipelines, the Commission by order issued June 3, 1975, in *Getty Oil Company, et al.*, in Docket No. CI75-319, *et al.*, directed that a formal hearing be held to resolve similar issues of depth limitations and limitation on the term of the sale.

The order of June 3, 1975, in Docket No. CI75-319 *et al.* (p. 1) states:

> "This proceeding involves issues of limitations in gas sales contracts, between independent producers and an interstate pipeline, for natural gas to be produced and sold from leases in the Federal Domain in the Gulf of Mexico, proposed to be certificated by the Federal Power Commission and accepted for filing.
>
> The producer gas sales contracts would limit dedications to the base of defined producing formations for a limited term. In view of the national shortage of natural gas and the declining gas reserves of interstate pipelines, the Commission directs a formal hearing on these issues. Applicants shall, *inter alia,* in their evidence address the question of whether the dedication of gas reserves to be connected from Federal Domain leases should not include all of the commercially producible gas reserves from the surface to the limit of the well bore."

Producers herein have proposed contracts limiting the term of the sale contract, reserving volumes of gas or percentages of total reserves or options to do so at their unilateral discretion, and containing depth limits.

In Docket No. CI75-538, Mobil Oil Corporation (Mobil) has on file an application to sell gas to Trunkline Gas Company (Trunkline) from Block 95 Field, Grand Isle Area offshore Louisiana in the Federal Domain. Trunkline Gas Company has a pending application in Docket No. CP75-273 to construct and operate facilities from the Block 95 Field to its existing offshore pipeline system.

[10]

Mobil's contract commits only 75 percent of the reserves in producing formations found between the top of the 4,500 Foot Sand (between 5,225 and 5,284 feet) and the base of the CN-10 Sand (between 10,175 and 10,102 feet) underlying specified portions of Blocks 93, 94, 95, and 96. The remaining 25 percent of the reserves in the dedicated depths is reserved for Mobil's own use. The term of the contract is 10 years.

On August 15, 1975, the Commission issued an order in *Trunkline Gas Company* and *Mobil Oil Corporation*, Docket Nos. CP75-273 and CI75-538, granting temporary certificates of public convenience and necessity and setting Mobil's application for hearing. The Commission found that in view of the National shortage of natural gas and the declining reserves of interstate pipelines, it was necessary that formal hearings be held to resolve similar issues of reservations, depth limitation and limitations on the term of the sale in *Getty Oil Company, et al.*, Docket No. CI75-319, *et al.* Mobil rejected the temporary certificate and sought reconsideration. On September 10, 1975, the Commission issued an order which, *inter alia*, granted in part Mobil's application for reconsideration. The Commission order further granted a permanent certificate with conditions to Mobil, and severed its application from the applications of the other producers. The permanent certificate stated that within 30 days after acceptance of the permanent certificate Mobil was required to file an amendment to its gas sales contract with Trunkline to delete any reservation of gas for Mobil's own use, to delete all depth limitations and to delete or amend the provision relating to the term of Mobil's proposed rate

schedule. The order directed that Mobil's permanent certification was conditioned on substitution of either a 20-year term in the contract amendment or deletion of the delivery term entirely, and substitution therefor of a life-of-the-lease, or equivalent term, whichever is preferable to the parties (p. 8).

By letter filed October 9, 1975, Mobil notified the Commission that it was rejecting the certificate, withdrawing the proposed amendment contained in its application for rehearing and gave notice to the Commission of its withdrawal of its application for a certificate. The Commission in the order issuing a permanent certificate on September 10, 1975, identified the ten year term of the Mobil's contract as an issue requiring resolution on permanent certification, because Trunkline shows gas supply available from this field for eighteen years based on proven and probable reserves, and 20 years based on proven, probable or potential reserves.

[11]

On October 9, 1975, Trunkline requested an extension of the period within which to formally accept the certificate tendered by the Commission for a 120 day period, because Trunkline's certificate is dependent upon the availability of gas from Mobil, and that Trunkline's proposal to construct and operate these facilities will continue regardless of the response from Mobil as Mobil's interest in the Block 95 Field remains committed to Trunkline under its Advance Payment Agreement. By Notice issued October 17, 1975, the Secretary extended to December 10, 1975, the date within which Trunkline must accept the certificate in Docket No. CP75-273. It is thus apparent to the Commission that the rejection of

certificates by Mobil and its purported withdrawal of its application has not terminated the proposal.

In order to expedite further consideration of all of these related matters, the Commission has determined that it is necessary and desirable in the public interest to reject Mobil's notice of withdrawal. The combination of facts, namely the acquisition by Mobil of Federal leases, the acceptance of large sums of advance payments from Trunkline, and the National shortage of natural gas compel further inquiry by the Commission as opposed to a summary grant of the requested withdrawal.

Mobil's application filed on August 22, 1975, states that it is prepared to accept a certificate unlimited as to duration, in support of Commission acceptance of a term of 10 years in Mobil's contract with Trunkline. On further consideration, the Commission finds that a certificate so conditioned should issue, based on the following considerations. Cases[2] decided under the Natural Gas Act,

[12]

to the finding that when the Commission certificates a sale lead

2. *City of Detroit v. Panhandle Eastern Pipeline Company*, 6 FPC 196, 204, affirmed, 143 F.2d 488, (8th Cir. 1944), affirmed, 324 U.S. 635 (1945); *Sunray Mid-Continent Oil Company v. FPC*, 364 U.S. 137, 156 (1960); *Hunt v. FPC*, 306 F.2d 334, 342 (5th Cir. 1962); *Panhandle Eastern Pipeline Company v. FPC*, 177 F.2d 942, 945 (6th Cir. 1949); *Michigan Consolidated Gas Company v. Panhandle Eastern Pipeline Company*, 173 F.2d 784, 789 (6th Cir. 1949); *Continental Oil Company*, 31 *FPC* 1079, 1083, affirmed, 385 U.S. 83 (1966); *Cities Service Gas Company*, 38 FPC 364, 378 (1967); *Blair-Vreeland*, Opinion Nos. 724 and 724-A (1975); *Mitchell Energy Corporation*, Opinion No. 733 (1975); *El Paso Natural Gas Company, et al.*, Opinion No. 737 (1975)

by a producer, and the gas begins to flow under the certificated authority, the certificated service authority is binding on both seller and buyer until such time as the Commission authorizes a change in the certificated service. The authorized service integrates the duty to continue to make the sale regardless of any contractual provision to the contrary. Moreover, the contract between Trunkline and Mobil was entered into on March 4, 1975, substantially before the issuance of Commission Order No. 529, in Docket No. RM75-6, which provides that advance payment agreements executed after June 17, 1975, shall, *inter alia.*, require long-term contracts for a minimum initial term computed on the lesser of 15 years or the life of the reserve in the field. The Commission will, therefore, amend the order of September 10, 1975, to permit the filing of the contract amendment without deletion of the 10-year term. However, this should not be construed as constituting any change in our policy stated in Order No. 529. Natural gas producers in the Natural Block 543 and TGP Blocks 249-50 projects will be accorded treatment consistent with the aforesaid.

In order to accommodate the various applicants involved in these offshore projects, the Commission will tender to the Natural gas producers, in the alternative temporary or permanent certificates. Where the producers accept permanent authorization pursuant to the certificates hereinafter issued, specific conditions will eliminate all controversial issues. This can be accomplished by the filing by each producer of a contract amendment consistent with these requirements.

The alternative tendered to each natural gas producer is a temporary certificate which sets the application of the

independent producer for hearing and decision and permits gas sales to commence as the Commission has previously permitted in the *Getty Oil Company, et al.*, Docket No. CI75-319, *et al.* Each natural gas producer therefore has the option of accepting a temporary certificate to commence operations and proceed to formal hearing on the issues raised by its contract for the sale of gas, or in the alternative accept a permanent certificate as conditioned and conclude action on its application.

By subsequent notice, the Secretary of the Commission will designate the applicants and Docket Nos. which will be the subject of the hereinafter scheduled hearing. Natural gas producers which accept neither permanent nor temporary authorization pursuant to this order will have their application set for hearing as part of the consolidated proceeding.

[13]

Natural will be required to file applications and received authorization to transport gas for Texas Eastern, Northern Natural, Columbia Gas and any other party seeking to have its purchased gas transported through the subject facilities prior to the actual transportation of gas for such parties.

Felmont, Superior, and Canadian Superior have not filed an application for the sale of gas representing their interest in these gas fields. Consistent with the Commission's action in *Marathon Oil Co.*, CI75-641, *et al.*, order issued July 24, 1975, *Texas Eastern, supra,* each of these companies will be directed to file with the Commission, a written statement within 10 days of this order advising the Commission of its intention with regard to its interest.

K-M and Chevron will submit copies of all operating Agreements affecting working interests in these fields. This requirement will be effective only so long as certificates are not issued and accepted by Felmont, Superior and Canadian Superior, as applicable to their respective field operations.

Petitions to intervene have been filed by:

Tennessee Gas Pipeline Company
Interstate Power Company
Northern Illinois Gas Company
Northern Indiana Public Service Company
Illinois Power Company
Iowa Southern Utilities Company
Iowa Power and Light Company
Mississippi River Transmission Corporation
Iowa-Illinois Gas and Electric Company
The Peoples Gas Light and Coke Company and North Shore Gas Company
Columbia Gas Transmission Corporation
Central Illinois Public Service Company
Northern Natural Gas Company
Peoples Natural Gas Division of Northern Natural Gas Company, and
Iowa Electric Light and Power Company

At a hearing held on November 19, 1975, the Commission on its own motion received and made a part of the record in these dockets all evidence, including the applications, as supplemented and amended, and exhibits thereto, submitted in support of the authorizations sought herein, and upon consideration of the record,

[14]

The Commission finds:

(1) Each Applicant here is a "natural-gas company" within the meaning of the Natural Gas Act as heretofore found by the Commission.

(2) The sale of natural gas hereinbefore described, as more fully described in the application will be made in interstate commerce subject to the jurisdiction of the Commission; and such sale by Applicant, together with the construction and operation of any facilities subject to the jurisdiction of the Commission necessary therefor, are subject to the requirements of Subsections (c) and (e) of Section 7 of the Natural Gas Act.

(3) It is necessary and appropriate in carrying out the provisions of the Natural Gas Act that the FPC gas rate schedule related to the authorizations hereinafter granted should be accepted for filing.

(4) Participation by petitioners to intervene may be in the public interest in the proceedings in which they have filed petitions.

(5) The sales of natural gas hereinbefore described and as more fully described in the applications of natural gas producers in these dockets will be made in interstate commerce subject to the jurisdiction of the Commission, and such sales by said persons, together with the construction and operation of any facilities subject to the jurisdiction of the Commission necessary, therefore, are subject to the requirements of subsection (c) and (e) of Section 7 of the Natural Gas Act.

(6) The transportation and sale of natural gas by applicants Natural Gas Pipeline Company and Tennessee Gas Pipeline Company, and the construction and operation of facilities will be subject to the jurisdiction of the Commission, are subject to the requirements of subsection (c) and (e) of Section 7 of the Natural Gas Act.

(7) The order of September 19, 1975, in Docket No. CI75-358 should be amended as to ordering paragraph (I) to remove the requirement for elimination of the 10-year term.

[15]

The Commission orders:

(A) Temporary certificates are issued to Applicants, Tennessee Gas Pipeline Company, a Division of Tenneco Inc., and Natural Gas Pipeline Company of America to construct and operate the subject facilities as hereinbefore described, all as more fully described in the applications, as amended and supplemented. The temporary certificates are conditioned upon each producer-applicant herein receiving and accepting permanent or temporary Commission authorization to sell gas to Tennessee, Natural, Columbia, Northern or Texas Eastern, as applicable to each pipeline project. This authorization is without prejudice to such ultimate disposition of the applications, as amended and supplemented, as the record may require.

(B) The certificates issued in paragraph (A) above and the rights granted thereunder are conditioned upon Applicants' compliance with all applicable Commission Regulations under the Natural Gas Act and particularly the general terms and conditions set forth in paragraphs (c)(1), (c)(3), (c)(4), (e), (f) and (g) of Section

157.20 of such Regulations. The construction authorized shall be completed within one year from the date of this order in accordance with paragraph (b) of Section 157.20 of the Regulations.

(C) The authorizations granted herein are conditioned upon the related producers who have filed for appropriate Commission authorization receiving and accepting permanent or temporary Commission authorization to sell natural gas to pipelines purchasers.

(D) All petitioners to intervene are permitted to intervene in all the proceedings in which they have filed petitions to intervene subject to the rules and regulations of the Commission; *Provided however,* that participation by such interveners shall be limited to matters affecting asserted rights and interests as specifically set forth in the petitions to intervene; and, *Provided, further,* that the admission of such interveners shall not be construed as recognition by the Commission that they might be aggrieved because of any order of the Commission entered in these proceedings.

(E) Permanent certificates of public convenience and necessity are issued upon the terms and conditions of this order authorizing the sale by natural gas producer applicants, herein of natural gas in interstate commerce for resale for ultimate public consumption, together with the construction and operation of any facilities subject to the jurisdiction of the Commission necessary therefor, subject to

[16]

Opinion No. 699, as amended, and any further orders

issued thereunder, conditioned to the seller of the contract rate or the national base rate of 51.0 cents per Mcf (14.73 psia), subject to upward and downward Btu adjustment from a base of 1,000 Btu per cubic foot, plus a 0.5 cent per Mcf gathering allowance, all as hereinbefore described and as more fully described in the applications in said dockets, subject to the following conditions.

(F) The certificates issued in paragraph (E) and (K) shall be void and without force or effect unless accepted in writing by Applicants within 30 days from the issue date of the order issuing such certificates; *Provided, however,* that if an application for rehearing of such order is filed in accordance with Section 19 of the Natural Gas Act, such acceptance shall be filed within 30 days from the issue date of the order of the Commission upon the application for rehearing or within 30 days from the date on which such application may be deemed to have been denied when the Commission has not acted on such application within 30 days after it has been filed; *Provided, further,* that if a petition for review is filed in accordance with the provisions of Section 19 of the Natural Gas Act, such acceptance shall be filed within 30 days after final disposition of the judicial review proceedings thus initiated.

(G) The certificates issued in paragraph (E) and (K) above and the rights granted thereunder are not transferable and shall be effective only so long as Applicants continue the acts or operations hereby authorized in accordance with the provisions of the Natural Gas Act and the requirements, rules, and regulations of the Commission.

(H) The grant of the certificates issued in paragraph (E) and (K) shall not be construed as a waiver of the requirements of Section 4 of the Natural Gas Act or of Part 154 or Part 157 of the Commission's Regulations thereunder and is without prejudice to any findings or orders which have been or which may hereafter be made by the Commission in any proceeding now pending or hereafter instituted by or against Applicants. Further, our action in this proceeding shall not foreclose or prejudice any future proceedings relating to the operation of any price or related provisions in the gas purchase contracts herein involved. The grant of the certificates herein for service to the particular customers involved shall not imply approval of all of the

[17]

terms of the contracts, particularly as to the cessation of service upon termination of said contracts as provided by Section 7(b) of the Natural Gas Act. The grant of the certificates herein shall not be construed to preclude the imposition of any sanctions pursuant to provisions of the Natural Gas Act for the unauthorized commencement of any sale of natural gas subject to said certificates.

(I) Producer-Applicants, upon acceptance of a permanent certificate in paragraph (E) above shall within 30 days of said acceptance file with the Commission an amendment to its gas sale contract to delete any reservation of gas for its own use and to delete all depth limitations. Applicants having advance payment agreements calling for 20-year contracts must delete or amend, where necessary, the provision relating to the term of its proposed rate schedule by either substitution of a 20-year

term or deletion of a delivery term entirely and substitution of life-of-lease (or equivalent) term, whichever is preferable to the parties.

(J) Section 154.93 of the Regulations under the Natural Gas Act is hereby waived to permit the inclusion in Applicants rate schedules of the contractual provision for rate increases to a higher area rate found to be proper by hearing, rulemaking or a Commission approved settlement and the reimbursement by buyer of any excess royalty payments. Such waiver should not be construed as meaning that any rate increase based on such pricing provision would be accepted for filing without suspension.

(K) Based upon the allegations presented upon the need for additional natural gas supplies, the Commission finds that an emergency exists and temporary certificates are hereby issued to natural gas producer Applicants herein pursuant to Section 7 of the Natural Gas Act authorizing the sale by Applicants in these docket of natural gas in interstate commerce for resale for ultimate public consumption, together with the construction and operation of any facilities subject to the jurisdiction of the Commission necessary therefor, subject to Opinion No. 699, as amended, and any further orders issued thereunder, conditioned to the lesser of the contract rate or the national base rate of 51.0 cents per Mcf (14.73 psia), subject to upward and downward Btu adjustment from a base of 1,000 Btu per cubic foot, plus a 0.5 cent per Mcf gathering allowance, subject to conditions stated above and hereafter.

[18]

(L) Applicants acceptance or rejection of the tempo-

rary certificates shall be filed within 30 days of the date hereof. If accepted, the temporary certificate shall be effective upon the date of receipt of the acceptance by the Secretary. Service under the temporary certificate shall commence within 30 days from the date of completion of the facilities by the purchaser transporter. Such service may not be discontinued without permission of the Commission issued pursuant to the provisions of Section 7(b) of the Natural Gas Act whether the contract term has expired or not. The issuance of temporary certificate and the acceptance of the rate schedule are without prejudice to such final disposition of the application for certificate as the record may require.

(M) The applications in Docket Nos. CP76-14, CP75-301, CI76-6, CI76-95, CI76-218, CI76-109, CI76-161, CS71-383, CS66-96, CS76-165, CI76-121, CI76-122, CI 76-142, CI76-238, CI76-260, CI76-265, CI76-266, and CI75-538 are hereby consolidated for hearing and decision. By subsequent notice, the Secretary of the Commission will delete herefrom each application which is concluded by acceptance of a permanent certificate issued by paragraph (E) above.

(N) On or before January 22, 1976, Applicants and all persons in support shall each file their prepared testimony and exhibits comprising their case-in-chief upon all parties to the proceeding, the Office of the Administrative Law Judges, the Commission Staff and all parties to the consolidated proceeding.

(O) The Chief Presiding Adfinistrative Law Judge shall designate a presiding officer to preside at the hearing hereinafter ordered. Subsequent to the date set for hearing

by this order, or any subsequent order or notice amending said hearing date, the delegated Administrative Law Judge shall control further proceedings consistent with the Rules and Regulations of the Commission and in compliance with this order.

(P) Pursuamt to the authority of the Natural Gas Act particularly Sections 7, 14, 15, 16 thereof, the Commission's Rules of Practice and Procedure, and the Regulations under the Natural Gas Act (18 CFR Chapter 1), a public hearing shall be held commencing February 17, 1976, at 10:00 a.m. (EST) in a hearing room at the Federal Power Commission, 825 North Capitol Street, N. E., Washington, D. C. 20426, concerning the matters in these consolidated dockets.

[19]

(Q) The Secretary of the Commission is directed to serve a copy of this order on Felmont Oil Corp., Case-Pomeroy Oil Corp., Superior Oil Company and Canadian Superior Oil Co..

(R) Each natural gas producer shall present as part of its prepared evidence in the consolidated hearing supporting data to show the volumes of natural gas to be produced and sold from each field in which it has an interest during the term of its contract from contractually specified formations; the estimated gross and net recoverable natural gas reserves in each formations in each field; the estimated gross and net recoverable natural gas reserves commercially producible from the surface to the limit of the well bore; and deliverability schedules related to each of the reserve estimates called for above. Each

natural gas producer shall also present a schedule of payments received and anticipated to be received from the interstate pipeline company proposing to purchase gas from the field. In order to reduce the volume of evidence submitted, a natural gas producer having an undivided interest in the Field may adopt the evidence of another producer as showing its reserves and deliverability.

(S) Felmont Oil Corp., Case-Pomeroy Oil Corp., Superior Oil Company and Canadian Superior Oil Company shall file a written statement within 10 days of the date of this order advising the Commission of its intentions with regard to its interest in Federal Domain Blocks 543 West Cameron area, and Blocks 249 250 South Marsh Island offshore Louisiana.

(T) The rate schedules and rate schedule supplements related to the authorizations granted herein are accepted for filing to become effective on the date of initial delivery. Applicants shall advise the Commission of said date within 10 days thereof.

The rate schedules have been designated as follows:

Description	*Designation*
Contract 9-1-1975	Kerr-McKee Corporation Rate Schedule No. 133 and Supplement No. 1 thereto.
Agreement 10-24-1975	
Contract 7-3-1975	Kerr-McKee Corporation Rate Schedule No. 132
Contract 7-16-1975	Cabot Corporation Rate Schedule No. 115

[20]

Description	*Designation*
Contract 9-1-75	Cabot Corporation, R.S. 116
Contract 9-1-75 Agreement 10-31-75	Felmont Oil Corporation R.S. 23 and Supplement No. 1
Contract 9-1-75	Case-Pomeroy Oil Corporation R. S. No. 6 and Supplement No. 1
Contract 7-10-75	Skelly Oil Company R. S. 280
Contract 7-9-75	Union Texas Petroleum, a Division of Allied Chemical Corporation R.S. 134
Contract 8-20-75 Agreement 3-23-73	Ocean Production Company, *et al.*, R.S. 13 and Supplement No. 1, thereto
Contract 7-25-75 Agreement 5-4-73	General American Oil Company of Texas R.S. 101 and Supplement No. 1
Contract 7-24-75	California Company, a Division of Chevron, R.S. 90
Contract 8-6-75	Aztec Oil & Gas Co., R.S. 40
Contract 8-4-75	Phillips Petroleum Co. R.S. No. 579

(U) Acceptance of the rate schedules of Applicants herein pursuant to temporary authorization in paragraph (K) does not constitute Commission approval of the contractual reservations or limitations involved pending

resolution of the matter on the merits after hearing and decision.

(V) Appropriate authorization from the Commission is required by any pipeline to transport any gas which the producers may be permitted to reserve.

(W) Within 30 days from the date of this order, producer-applicant in CI76-142 shall file three copies of a written statement demonstrating the applicability of the rate, terms and conditions of Opinion No. 699-H. If such statement is filed with the Secretary within 30 days, the rate may be made effective as of the date of initial delivery.

[21]

(X) The Motion for rehearing of Natural Gas Pipeline filed October 17 in Docket No. CP76-14 is hereby denied to the extent not granted above.

(Y) The certificate authorization to Natural to construct facilities is conditioned on the cost of such facilities not becoming part of Natural's rate base until such time as these facilities are operational and the producers proposing to sell gas to the pipeline companies from the Block 543 Field have accepted authorization to sell gas. Natural's request for waiver of Section 2.65(a)(4) will be considered at such future time as the Commission acts on the application by Natural for issuance of permanent certification. Natural is further directed to file applications for transportation of gas for other pipeline purchasers and receive such authorizations prior to the initiation of any such transportation service from the Block 543 Field, Stingray, Natural and Tennessee shall

file appropriate rate schedules 30 days prior to the initiation of any transportation service for natural gas producers for the transportation of liquids from these Fields, together with a supporting cost-of-service exhibit.

(Z) The Secretary of the Commission shall serve a copy of this order on the Secretary of the Interior inviting his participation in this proceeding, to notify the Department of the status of these Federal leases, and to permit the Secretary to take whatever action he deems necessary in the circumstances.

(AA) Applicants GAOCT and Aztec shall file a contract amendment deleting the favored-nations clause from their contracts within 30 days from the date of this order.

(BB) Within 30 days from the date of this order, applicants in Docket Nos. CI76-6, CI76-95, and CI76-101 shall file the written statement demonstrating the applicability of the rate, terms and conditions of Opinion No. 699-H, including the written waiver required by Section 2.56a(i) of the rules. If such statement is filed with the Secretary within 30 days, the rate may be made effective as of the date of initial delivery.

(CC) Within 30 days from the date of this order, applicants in Docket No. CI76-109, CI76-218, CI76-260, CI76-265, and CI76-266 shall file the written waiver required by Section 2.56a(i) of the rules. If such waiver is filed within 30 days, the rate may be made effective as of the date of initial delivery.

[22]

(DD) Within 30 days from the date of the order, applicants in Docket Nos. CI76-109, CI76-121, CI76-142,

CI76-218, CI76-265 and CI76-266 and CI76-238 shall file three copies of a revised billing statement which clearly reflects the components of the authorized rate, namely, base rate, Btu adjustment and gathering allowance.

(EE) Applicant in Docket Nos. CI76-238, CI76-260, CI76-265 and CI76-266 shall obtain Commission authorization before reserves may be substituted pursuant to Section 5 of Article III of the related gas sales contract.

(FF) Chevron, GAOCT and Ocean shall show cause in the hearing ordered (where these applicants accept temporary certificates) by their evidence why the term of their contracts for sale of gas should not be amended to be equivalent to the term (20 years) prescribed in the advance payment agreements with TGP. This condition shall be void where each of these applicants accepts a permanent certificate.

(GG) Chevron and K-M shall file copies of all operating agreements in these Fields so long as certificates are not issued and accepted by Felmont, Superior, Canadian Superior, as applicable to their respective field operations herein.

(HH) Applicant natural gas company's attention is directed to Commission Order No. 539, issued October 14, 1975, F.R. , and to the provisions of Section 2.83 General Policy and Interpretations, 18 CFR 2.83. Moreover, issuance of this certificate authorization is conditioned to require Applicant, within 30 days of the initial reserve determination or any subsequent redetermination thereof, to report the results of each such initial or redetermination study to the Commission. The

certificated minimum daily delivery obligation of the Seller (1) shall be determined in accordance with applicable provisions specifically set forth in seller's contract unless otherwise changed by the certificate authorization; (2) shall be without regard to any contractual reservations contrary to the certificate authorization; (3) and shall remain in full force and effect unless and until changed by appropriate certificate authorization amendment based upon Applicant's full documentation of, *inter alia,* the reasons for any such proposed amendment, the sales production history, the amount of remaining connected reserves of Applicant dedicated under the contract and the status of Applicant's nondeveloped reserves

[23]

dedicated under the contract. The certificate authorization is further conditioned to require that Applicant, if it has not secured an appropriate certificate amendment and there are circumstances resulting in the delivery of a lesser quantity of natural gas than any certificated delivery obligation, Applicant shall file for each contract year quarter, a verified report setting out the circumstances of such lesser deliveries and the corrective actions which Applicant proposes to undertake in order to meet any experienced delivery deficiency, such verified reports to be filed within 10 calendar days after expiration of each contract year quarter.

(II) Certificates issued by this order to natural gas producers and gas begins to flow under such authority makes the certificated service authority binding on both seller and buyer until such time as the Commission au-

thorizes a change in the certificated service regardless of any contractual provision to the contrary.

(JJ) Trunkline, natural and TGP shall file within 45 days after service commences under the certificates issued herein, a verified statement showing *pro forma* Form 15 gas reserves and deliverability schedules for these fields, and representations of reserves controlled which will be made to stockholders, or contained in a prospectus or registration statement in connection with financing or financial reporting.

By the Commission. Commissioner Smith, dissenting in part and concurring in part, filed a separate statement appended hereto.

(SEAL)

Kenneth F. Plumb,
Secretary.

[1]

Natural Gas Pipeline Company of America, *et al.*	))	Docket No. CP76-14, *et al.*

Issued November 21, 1975)

SMITH, Commissioner, *dissenting in part and concurring in part:*

I dissent to the instant order for the reasons set forth in my dissenting statement to "Order Setting Hearing Date, Prescribing Procedures, Consolidating Proceedings And Granting Temporary Authorization," *Getty Oil Company, et al.*, Docket No. CI75-319, *et al.*, issued June 3, 1975. However, I note that the Commission has today modified its apparent position set forth in the *Getty* order, *supra*, page 1, which implied that the dedication of gas in interstate commerce is limited to the term of the contract, which removes one ground for my dissent thereto. It has long been settled that once gas is dedicated by Commission certification to interstate commerce, deliveries of such gas cannot be terminated without prior FPC approval, pursuant to Section7(b) of the Natural Gas Act, 15 U.S.C. 717, irrespective of the length and expiration date of the underlying contract. See, *e.g.*, *Sunray Mid-Continent Oil Company v. F.P.C.*, 364 U.S. 137 (1960).

Hence, the fact that the Commission certificates sales made under a contract of limited duration has no bearing on the producers' obligation to deliver the certificated volumes of gas *until abandonment authorization is obtained*. The Majority today has overruled that portion of *Getty* and I concur in this result.

DON S. SMITH
Don S. Smith, Commissioner

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

[Title omitted in printing]

Reference to the Opinion of the
Court of Appeals for the Fifth Circuit

(Dated January 20, 1978)

The Opinion of the Court of Appeals for the Fifth Circuit in this case, 566 F.2d 536 (5th Cir. 1978), has been reproduced as Appendix A in the Petition for a Writ of Certiorari No. 77-1652, *Federal Energy Regulatory Commission* v. *Shell Oil Company, et al.*, and as Appendix A in the Petition for a Writ of Certiorari No. 77-1654, *Consumer Federation of America, Energy Policy Task Force* v. *Federal Energy Regulatory Commission.*

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

[Title omitted in printing]

Reference to the Judgment of the
Court of Appeals for the Fifth Circuit

(Dated January 20, 1978)

The Judgment of the Court of Appeals for the Fifth Circuit has been reproduced as Appendix B in the Petition for a Writ of Certiorari No. 77-1652, *Federal Energy Regulatory Commission* v. *Shell Oil Company, et al.*

SUPREME COURT OF THE UNITED STATES

No. 77-1652

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

SHELL OIL COMPANY, ET AL.

ORDER ALLOWING CERTIORARI

Filed October 2, 1978

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted. The case is consolidated with No. 77-1654 and a total of one hour is allotted for oral argument.

Mr. Justice Stewart took no part in the consideration or decision of this petition.

SUPREME COURT OF THE UNITED STATES

No. 77-1654

CONSUMER FEDERATION OF AMERICA,
ENERGY POLICY TASK FORCE, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ORDER ALLOWING CERTIORARI

Filed October 2, 1978

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FILED
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MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1652

FEDERAL ENERGY REGULATORY COMMISSION, *Petitioner,*

v.

SHELL OIL COMPANY, ET AL., *Respondents,*

No. 77-1654

CONSUMER FEDERATION OF AMERICA,
ENERGY POLICY TASK FORCE, *Petitioner,*

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petitions for Writs of Certiorari
To the United States Court of Appeals for the Fifth Circuit

BRIEF OF RESPONDENT STATE OF LOUISIANA IN OPPOSITION

Honorable EDWIN W. EDWARDS
Governor, State of Louisiana

Honorable WILLIAM J. GUSTE, JR.
Attorney General, State of Louisiana

Honorable WILLIAM B. HUIS
Secretary, Department of Natural Resources, State of Louisiana

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1652

FEDERAL ENERGY REGULATORY COMMISSION, *Petitioner,*

v.

SHELL OIL COMPANY, ET AL., *Respondents,*

No. 77-1654

CONSUMER FEDERATION OF AMERICA,
ENERGY POLICY TASK FORCE, *Petitioner,*

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petitions for Writs of Certiorari
To the United States Court of Appeals for the Fifth Circuit

BRIEF OF RESPONDENT STATE OF LOUISIANA IN OPPOSITION

Respondent State of Louisiana (Louisiana) submits the following brief in opposition to the petitions for writs of certiorari which have been filed by the Federal Energy Regulatory Commission (Commission) and the Consumer Federation of America, Energy Policy Task Force. These petitions seek review of a Fifth Circuit decision overturning an attempt by the Commission to eliminate the "production or gathering"

exclusion of the Natural Gas Act and to encroach on areas expressly reserved to the states by Congress.

QUESTION PRESENTED

Whether the Natural Gas Act precludes the Commission from regulating the physical activities of production of natural gas by establishing a "prudent operator" standard in certificates of public convenience and necessity authorizing sales of natural gas in interstate commerce.

STATEMENT OF THE CASE

In the interest of brevity, Louisiana will not recount the procedural history of this proceeding, an undertaking which has been performed by Respondents Tenneco Oil Company and Pennzoil Company.

REASONS FOR DENYING THE WRITS

1. The Decision Below is Required by This Court's Established Construction of the Natural Gas Act.

In establishing a regulation requiring a producer to act as a "prudent operator" in developing and maintaining deliverability of gas reserves, the Commission improperly endeavored to thwart the congressional purpose of the Natural Gas Act as interpreted by this Court. Even now it makes no effort to disguise its position: the Commission has "some jurisdiction over the physical acts of the producer and the physical operation of the facilities by which certificated service is rendered." (Commission Pet. at 8-9).

But as the court of appeals properly ruled, if the Commission's assertion were correct, it "would all but eliminate the 'production or gathering' exclusion and would allow the FERC to encroach on areas reserved

to the states." In so ruling, the court of appeals followed the plain language of the Act and the precedent of this Court interpreting the limits of the Commission's jurisdiction. Any other action would have run counter to the strong congressional intent that the role of the states in the regulation of natural gas not be supplanted.

A proper reading of the Act demonstrates that the inclusion of a "prudent operator" standard into certificates is an action beyond the Commission's jurisdiction. Section 1(b) of the Act clearly sets forth the scope of the Commission's jurisdiction, which is limited to:

> . . . the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, . . . 15 U.S.C. § 717(b).

In drafting the Act, Congress took care specifically to withhold jurisdiction from the Commission in certain areas. Thus, section 1(b) of the Act states that the provisions of the Act shall not apply to ". . . the production or gathering of natural gas." 15 U.S.C. § 717(b).

This Court has consistently emphasized that the Act grants *limited* authority to the Commission and that Congress meticulously precluded the Commission from exercising jurisdiction in any but three areas.

> Three things and three only Congress drew within its own regulatory power, delegated by the Act to its agent, the Federal Power Commission. These were: (1) the transportation of natural gas in

interstate commerce; (2) its sale in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale. *Panhandle Eastern Pipe Line Company* v. *Public Service Commission*, 332 U.S. 507, 516 (1947).

Additionally, in *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949), this Court said

> Without entering upon another review of its legislative history, suffice it to say that the Natural Gas Act did not envisage federal regulation of the entire natural-gas field to the limit of constitutional power. Rather it contemplated the exercise of federal power as specified in the Act, particularly in that interstate segment which the states were powerless to regulate because of the Commerce Clause of the Federal Constitution. The jurisdiction of the Federal Power Commission was to complement that of the state regulatory bodies. Accordingly, Congress in § 1(b) of the Act not only prescribed the intended reach of the Commission's power, *but also specified the areas into which this power was not to extend*. 337 U.S. at 503. (emphasis added).

An area recognized as expressly exempted from the Commission's jurisdiction is "the production or gathering of natural gas." Congress intended that the power to regulate production activities would remain vested in the states and that they would continue to regulate these activities.

In passing the Act, Congress took care not to supplant any authority of the states but rather sought to regulate the area which the states could not reach. Thus, in *Panhandle Eastern Pipe Line Co.* v. *Public Service Commission, supra,* this Court recognized that:

> The Act, though extending federal regulation, had no purpose or effect to cut down state power. On the contrary, perhaps its primary purpose was to aid in making state regulation effective, by adding the weight of federal regulation to supplement and reinforce it in the gap created by the prior decisions. The Act was drawn with meticulous regard for the continued exercise of state power, not to handicap or dilute it in any way. 332 U.S. at 517-518.

Further, in *FPC* v. *Panhandle Eastern Pipe Line Co., supra,* this Court stated:

> The legislative history of this Act is replete with evidence of the care taken by Congress to keep the power over the production and gathering of gas within the states. This probably occurred because the state legislatures had delegated broad and elaborate power to their regulatory bodies over all aspects of producing gas. The Natural Gas Act was designed to supplement state power and to produce a harmonious and comprehensive regulation of the industry. *Neither state nor federal regulatory body was to encroach upon the jurisdiction of the other.* Congress enacted this Act after full consideration of the problems of production and distribution. It considered the state interests as well as national interests. 337 U.S. at 509-514. (emphasis added).

The Act specifically preserved the rights which the states could exercise and were exercising when the Act was passed. The assertion of Commission jurisdiction over production activities which Louisiana and the other producing states have regulated for years would be inconsistent with the congressional purpose—often cited by this Court—not to invade the powers or prerogatives of the states.

As the court of appeals noted, the Commission points to no case which extends its jurisdiction into the physi-

cal activities of production. Indeed, decisions of this Court have found "production activities" to be entirely separate from sales of gas subject to the Commission's jurisdiction. This distinction was underscored in this Court's first *Phillips* decision, *Phillips Petroleum Company* v. *Wisconsin,* 347 U.S. 672 (1954).

> . . . production and gathering, in the sense that those terms are used in § 1 [illegible]), end before the sales by Phillips occur. 347 U.S. at 678.

Even more specifically, this Court has stated that the production and gathering exemption means that the Commission has ". . . no control over the drilling and spacing of wells and the like." *Colorado Interstate Gas Co.* v. *FPC,* 324 U.S. 581, 603 (1945). Further, this Court has held that the transfer of undeveloped gas leases is not within the Commission's jurisdiction. *FPC* v. *Panhandle Eastern Pipe Line Co., supra.*

Thus, consistent with the express language of the Act excluding production activities from the Commission's jurisdiction and the clear precedent of this Court, the court of appeals correctly held that granting the Commission jurisdiction to issue Order No. 539-B "would all but eliminate the 'production or gathering' exclusion and would allow the FERC to encroach on areas reserved to the states."

2. The Interpretation of the "Prudent Operator" Standard is a Question For State Courts.

The "prudent operator" standard is incorporated in the rules and regulations of state conservation agencies and has been interpreted by state courts in resolving

questions arising under oil and gas leases.[1] Since the Commission has neither the authority nor the expertise to enforce a standard which is created and defined by state law, the Commission's attempt to enforce the "prudent operator" standard in certificates undermines the dual federal-state regulatory scheme envisioned by Congress.

The interpretation and enforcement of the "prudent operator" standard involves solely questions of state law and must properly be left to the states for decision and action. Otherwise, the potential exists for intolerable conflict between state and federal agencies over the proper interpretation of state law. Such conflicts not only are unnecessary but also are impermissible, since Congress took care to exclude the possibility of any such conflict by specifically precluding Commission regulation of production activities.

---

[1] In Order No. 539-B, the Commission stated that:

> The prudent operator standard has long been established as an implied covenant in lease agreements, which means that producers are very familiar with the requirements of this standard. Furthermore, state regulatory agencies, whose principal purpose is conservation of natural resources, require producers to conform with the responsibilities imposed by the prudent operator standard.

See, e.g., Title 30, Louisiana Revised Statutes (1950).

CONCLUSION

Because this Court has settled the question of whether the Commission can negate the production and gathering exclusion of the Act and thereby encroach on areas reserved to the states, a writ of certiorari should not be granted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

NO. 77-1652

FEDERAL ENERGY REGULATORY COMMISION,
Petitioner,
v.
SHELL OIL COMPANY, ET AL.,
Respondents.

NO. 77-1654

CONSUMER FEDERATION OF AMERICA,
ENERGY POLICY TASK FORCE,
Petitioner,
v.
FEDERAL ENERGY REGULATORY COMMISION,
Respondent.

BRIEF OF RESPONDENT PRODUCERS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI

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Shell Oil Company, *et al.*[1] (herein called "Producers") who were petitioners or intervenors in the case below

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1. A complete list of the Producers joining herein is contained on the inside cover of this Brief.

respectfully submit their Brief in Opposition to the petitions filed in Case Nos. 77-1652 and 77-1654 for writs of certiorari to review the opinion and judgment of the United States Court of Appeals for the Fifth Circuit entered in this case on January 20, 1978.[2]

STATEMENT OF POSITION

The Court of Appeals correctly interpreted Section 1 (b) of the Natural Gas Act (15 U.S.C. § 717(b) 1970)[3] as denying the Commission's jurisdiction to regulate the production activity, as distinguished from its authority to regulate a sale in interstate commerce for resale. Such production activity was, at the time the Natural Gas Act was passed, and still is, extensively regulated by state conservation agencies. Such operations are also under the constant scrutiny of the lessor in the oil and gas lease under which the producer operates, who has extensive rights under state law to insure these operations are conducted in a diligent manner. For these reasons, Congress in enacting the Natural Gas Act and this Court in construing the producer's obligations under that Act, have always drawn a careful distinction between regulation of the production activity and regulation of the act of selling gas in interstate commerce for resale. The Commission cannot, as it sought to do in the Order below, obliterate that distinction by imposing certificate conditions under Section 7(e) of the Act, or by broadening its authority over abandonments under Section 7(b) of the Act.

2. The Court of Appeals' opinion is attached as Appendix A to the Petition in Case Nos. 77-1652, *et al.* References to that opinion will refer to the pages in that Appendix.

3. See Appendix D to the Petition in Case No. 77-1652.

STATEMENT OF FACTS

This proceeding was founded on two basic misconceptions of fact and law. The first of these is that the gas shortage now prevalent in the United States is the result of withholding from the market of natural gas supplies by producers in an attempt to obtain price relief from the Commission or to induce Congress to deregulate gas prices. These charges have been extensively investigated not only by the Commission but by Congressional Committees, the Federal Trade Commission, and the Department of Interior, and have been discredited. In oral argument before the Court of Appeals, the Commission's counsel agreed that the Commission had found no evidence of gas withholding by producers.[4] The real cause of the gas shortage is the decline in deliverability in the older producing fields which is a normal incident of a depletion of those fields, coupled with the inability of the producing industry, acting under the price constraints imposed by the Commission under the Natural Gas Act, to find new gas supplies at a rate equivalent to the depletion rate of the older fields.

While conceding that there was no evidence that producers were actually withholding gas supplies, both petitioners alleged that the producers have both the motive and the opportunity to do so unless restrained by Commission regulation. Neither of these allegations is correct. The alleged motive, to obtain some possible higher price at a later date, is more than offset by the risk that if the producer does not act diligently he may never recover the gas under his lease at all. Gas moves freely through the reservoir rock, and is not confined by lease

4. Petition, Appendix A, p. 3a.

boundaries. If one producer shuts in his lease, his gas will be produced by the offsetting lessee and lost to him forever. Thus, there could be no possible motive for a producer to deny himself not only a return on his investment but a recovery of his costs by deferring that return to some nebulous point in the future.

Nor does the producer have the opportunity to be indolent or careless in his development and production operations, as the Commission would imply (pp. 11 and 15), absent Commission regulation. State conservation laws etxensively regulate the production and development of oil and gas reservoirs.[5] The validity of these laws was upheld by this Court in *Champlin Refining Co. v. Corporation Commission*, 286 U.S. 210 (1931). In addition to the state conservation laws, the lessor of the oil and gas lease has extensive legal rights to insist that its lessee operate in a diligent manner. The penalty for failure can be loss of the lease and extensive monetary damages.[6] In the offshore area, where the lessee is the Bureau of Land Management of the Department of Interior under the Outer Continental Shelf Lands Act (67 Stat. 462), the Department's Regulations provide specifically for the exercise of diligence by the lessee (43 C.F.R. §§ 3307.3-2, 3307.3-4.

The second major misconception, which formed the basis of this proceeding below and petitioners' argu-

5. See *e.g.*, 52 Okla. Stat. § 274 (1971); N.M. Stat. Ann. 65-3-13, *et seq.*, (1953); Vernon's Tex. Civ. Stat. Ann. art. 6049 C, *et seq.* (1962); Kan. Stat. Ann. 55-701, *et seq.*; West's La. Stat. Ann. R.S. 30:4, *et seq.* and Ark. Stat. § 55-109, et seq.

6. Summers, *Oil and Gas Law*, §§ 454-472, pp. 149-392 and Williams and Meyers, *Oil and Gas Law*, Vol. 5, § 815, pp. 75-6 and § 825, pp. 153-76.

ments here, is the concept that when a producer entered into a gas sales agreement to sell the gas from a given field or reservoir, and obtained a certificate from the Commission authorizing such sale, that the producer somehow guaranteed that the reservoir would continue to produce at its initial rate forever, or at least at some predictable and measureable rate of decline. This assumption is simply not in accordance with the facts in a normal gas field. Gas moves through porous spaces in the reservoir rock in response to its pressure, and that of adjacent liquids, in complex and unpredictable ways. Projections of this performance are necessarily imprecise and frequently in error, and subject to continual change as the production reservoir continues. The producer does not agree or guarantee what the deliverability rate of a reservoir will be at the time he signs his contract, or applies for his certificate.[7]

In the Order here under review, the Commission recognized that the typical contract or certificate did not contain any specific delivery obligations or guarantees, but insisted that there was an implied obligation on the

7. Although the Commission has now conceded the point, Consumer Federation of America ("CFA") continues to argue that the producer's certificate contains a delivery obligation. Failing to find any such obligation in either the contract or the express language of the certificate, CFA seeks to imply one from the material filed with the producer's application for the certificate (18 C.F.R. §§ 157.23-157.25). But the only data bearing on such an obligation in this section of the regulations is an estimate of the first month's deliveries, which all parties concede will not necessarily apply to the second or any subsequent month. Failing again in this attempt, CFA turns to the data filed by the pipeline buyer (18 C.F.R. § 157.14). But the pipeline's source of supply comes from many producers in many fields, and its deliverability estimates are based on a composite of these sources. In short, the "certificate obligation" to produce specified quantities of gas to which CFA refers throughout its petition simply does not exist.

part of the producer to operate as an ordinary prudent operator. Producers have long recognized their obligation to develop and produce their leases in a diligent manner, and in accordance with what is described as the "ordinary prudent operator" test (see Appendix A, p. 19a). The state courts and conservation agencies, which developed this rule, are the proper forums for its enforcement. The question rather, is whether the Commission has been empowered under the Natural Gas Act to enforce this obligation. This question, the extent of the jurisdiction of the Commission over the producer's production activities, has long been settled by decisions of this Court.

REASONS FOR DENYING THE WRIT

This Court stated the objective of the Natural Gas Act in *Federal Power Commission v. Panhandle Eastern Pipe Line Company*, 337 U.S. 498, 513, as follows:

> "The Natural Gas Act was designed to supplement state power and to produce a harmonious and comprehensive regulation of the industry. Neither state nor federal regulatory body was to encroach upon the jurisdiction of the other. Congress enacted this Act after full consideration of the problems of production and distribution. It considered the state interests as well as the national interest. It had both producers and consumers in mind. Legislative adjustments were made to reconcile the conflicting views." (337 U.S. 498, 513) (nn. omitted)

This case follows other clear holdings by this Court. The Natural Gas Act was passed to fill the gap in regulation which the states could not reach, see *Panhandle Eastern Pipe Line Company v. Public Service Commission of Indiana*, 332 U.S. 507 (1947); *Public Utilities*

Commission v. Attelboro Steam & Electric Company, 273 U.S. 83 (1927); *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*, 314 U.S. 498, 506-08 (1942); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 609-13 (1944), and *Interstate Natural Gas Co. v. Federal Power Commission*, 331 U.S. 682, 689-90 (1947).

In *Colorado Interstate Gas Co. v. Federal Power Commission*, 324 U.S. 581 (1945), after finding that the Commission could include production properties in the rate base of an interstate pipeline company, this Court stated:

> "That does not mean that the part of § 1(b) which provides that the Act shall not apply 'to the production or gathering of natural gas' is given no meaning. Certainly that provision precludes the Commission from any control over the activity of producing or gathering natural gas. For example, it makes plain that the Commission has no control over the drilling and spacing of wells and the like." (324 U.S. 581, at 602-03)

The Commission takes the position (p. 13) that this Court's opinion in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954) finding that the FPC had authority to regulate producer sales of natural gas in interstate commerce for resale operated to destroy the "production and gathering" exclusion of Section 1(b) of the Act. Contrary to the Commission's position, this Court clearly reiterated the distinction between transportation and sale and production and gathering, saying:

> "Similarly, in Colorado Interstate Gas Co. v. Federal Power Com. 324 US 581, 598, 89 L ed 1206, 1220,

> 65 S Ct 829, we stated that '[t]ransportation and sale do not include production or gathering,' and indicated that the 'production or gathering' exemption applies to the physical activities, facilities, and gathering of natural gas." (347 U.S. 672, at 678)[8]

This Court made its intent even clearer in *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965) as to the distinction between Commission's jurisdiction over the sale of gas in interstate commerce for resale and its lack of jurisdiction over the physical activity of production and gathering. This Court said:

> ". . . '[P]roduction or gathering' exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction. This accommodation of the two relevant clauses of § 1(b) gives content to the national objectives of the Natural Gas Act as expounded in Phillips, and to the Commission's jurisdiction to accomplish them, while in no way interfering with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate state concerns." (381 U.S. 392, at 402-03)

This Court had previously sustained the validity of state conservation laws on the grounds that there jurisdiction over production did not interfere with interstate commerce as production was essentially a mining operation even though the product obtained was intended to be and was immediately shipped in interstate commerce, *Champlin Refining Co. v. Corporation Commission*, 286 U.S. 210, 235 (1931).

8. The Supreme Court did not disturb the Commission's finding that the production and gathering facilities were non-jurisdictional, *Phillips Petroleum Co.*, 10 F.P.C. 246 (1951).

Nor does *Sunray Mid-Continent Oil Co. v. Federal Power Commission*, 364 U.S. 137 (1960) hold otherwise. As noted by the Court of Appeals (Appendix A, p. 7a), this case, as well as *Sun Oil Co. v. Federal Power Commission*, 364 U.S. 170 (1960), merely hold that a producer who has wells fully capable of continuing production cannot discontinue deliveries in interstate commerce from those wells when his contract expires. This holding is a far cry from finding jurisdiction in the Commission to require the producer to drill additional wells or make additional capital expenditures to expand production, which is the authority claimed by the Commission under the Order below.

At the conclusion of its Opinion the Court of Appeals stated:

> "To hold that the power to issue Order No. 539-B is within the jurisdiction of the FERC would all but eliminate the 'production or gathering' exclusion and would allow the FERC to encroach on areas reserved to the states. We cannot so extend the authority of the Commission." (App. A, pp. 9a-10a) (n. omitted)

The Opinion of the Court of Appeals is correct and should be allowed to stand.

Respectfully submitted,

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Respondent.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF RESPONDENTS TENNECO OIL COMPANY AND PENNZOIL COMPANY IN OPPOSITION

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OPINIONS BELOW AND JURISDICTION

The opinions below are correctly referenced and the jurisdictional prerequisites are adequately set forth in the petitions for a writ of certiorari.

QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission (Commission) has authority to regulate the physical activities of production of natural gas either directly or indirectly by imposing conditions on production activities in certificates of public convenience and necessity authorizing sales of natural gas in interstate commerce for resale.[1]

STATUTES INVOLVED

Sections 1(b), 7(b), 7(c), and 7(e) of the Natural Gas Act, 15 U.S.C. §§ 717(b), 717f(b), 717f(c), and 717f(e) are correctly set forth in the Commission's Petition For a Writ of Certiorari.

STATEMENT OF THE CASE

By its Order 539-B, which is the subject of this proceeding, the Commission adopted a new Section 157.41 of its Rules and Regulations. Section 157.41 provides that on and after July 30, 1976 every producer certificate authorizing the sale of natural gas in interstate commerce for resale shall contain a condition requiring the seller to operate the property from which the gas is to be produced as a "prudent operator". The Commission also concluded in Order 539-B that this development and production condition is "implicit" in all producer certificates issued prior to July 30, 1976. Thus, by Order 539-B the Commission has undertaken to regulate the activities of producers in the operation of their oil and gas properties.

On review, the United States Court of Appeals for the Fifth Circuit vacated Order 539-B, holding that the Commission has no authority to regulate production activities. Specifically, the Court held that Section 1(b) of the Natural

[1] A second question is raised in the Petition filed by Consumer Federation of America. Because that issue was not decided in any manner by the Court of Appeals, it has no bearing on whether the Petitions should be granted.

Gas Act,[2] as interpreted on numerous occasions by this Court, expressly excludes from the Commission's jurisdiction the physical activities of production.

ARGUMENT

A writ of certiorari should not be granted in this case because the single question presented has already been answered by this Court on numerous occasions. The question is whether the Commission has the authority to regulate the physical activities of the production of natural gas. Based on the express language of Section 1(b) of the Gas Act this Court has answered that question in the negative in *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965), in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), in *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949), and in *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581 (1945).

THE COMMISSION DOES NOT HAVE THE AUTHORITY TO REGULATE PRODUCTION ACTIVITIES

The Commission does not dispute the fact that the Section 157.41 condition adopted by Order 539-B is an assertion by the Commission of jurisdiction over the production activities of producers. Indeed, in adopting Section 157.41, the Commission expressly acknowledged that it was undertaking to regulate " . . . what a reasonably prudent producer would do with respect to the *drilling, completion, workover, recompletion, or abandonment of wells.*" (Commission Pet. at 20a). In its Petition for a Writ of Certiorari, the Commission acknowledged that under Order 539-B, regulation would extend even over the normal operation and maintenance of individual wells. Thus, the Commission's basic position before this Court is that it has "some jurisdiction over the physical acts of the producer and the physical

[2] 15 U.S.C. § 717(b).

operation of the facilities by which certificated service is rendered." (Commission Pet. at 8, 9).

The issue is therefore clearly presented: does the Commission have jurisdiction to regulate the physical activities of production? The answer is also clear: the Commission does not have such jurisdiction. To hold otherwise would be contrary to the intent of Congress and the statutory mandate of the Gas Act.

The Commission's jurisdiction under the Gas Act is set forth in its entirety in Section 1(b) of the Act. That section grants the Commission jurisdiction over the transportation of natural gas in interstate commerce, the sale in interstate commerce of natural gas for resale, and natural gas companies engaged in such transportation or sale. Section 1(b) also specifically provides that the Commission shall *not* have jurisdiction over " . . . the production . . . of natural gas."

The express language of the statute is therefore clear and unambiguous in excluding production activities from the Commission's jurisdiction. Likewise, this Court has recognized this exclusion on numerous occasions in equally clear and unambiguous language. Thus, in *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581 (1945), this Court described the reach of the production exemption as follows:

> "Certainly that provision precludes the Commission from any control over the activity of producing or gathering natural gas. For example, it makes plain that the Commission has no control over the drilling and spacing of wells and the like." 324 U.S. at 602-3. (emphasis added).

This Court again addressed the meaning of the Section 1(b) production exemption in *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949). The Court first recognized that Section 1(b) contains not only a grant of jurisdiction, but also identifies areas expressly excluded from

the Commission's jurisdiction. Among the activities which the Court recognized as being expressly excluded from the Commission's jurisdiction is " . . . the production and gathering of natural gas."[3] Referring to the scope of the production and exemption as set forth in *Colorado Interstate*, the Court once again adhered " . . . to this natural and clear meaning of the words and their obvious expression of congressional intent."[4] Indeed, in *Panhandle* the Commission itself expressly recognized that "the activities of production and gathering, such as drilling, spacing wells, or collecting gas . . . were excluded from the coverage of the Act."[5]

Finally, after determining in *Phillips Petroleum Co.* v. *Wisconsin*[6] that the Commission has jurisdiction over sales of gas by independent producers in interstate commerce for resale, this Court again addressed the meaning of the production exemption of Section 1(b). And, consistent with *Colorado Interstate, Panhandle Eastern*, and the clear language of the Act, the production exemption was once again construed to encompass "the physical activities, processes, and facilities of production. . . . " *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392, 402 (1965).

Despite the "obvious expression of congressional intent" to preclude Commission jurisdiction over production activities, this Court's determination that the Commission has no jurisdiction over "the physical activities, processes, and facilities of production", and the Commission's own prior representation to this Court that it has no jurisdiction over the activities of production, the Commission now asserts such jurisdiction. Significantly, in making this assertion the Commission does not rely on Section 1(b), which is the only source of its jurisdiction. Instead, the Commission

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[3] 337 U.S. 498, 504.

[4] 337 U.S. 498, 504-5.

[5] *Id.* at 504.

[6] 347 U.S. 672 (1954).

relies on those Sections of the Act which do nothing more than set forth the Commission's powers with respect to those matters which are within the Commission's jurisdiction by virtue of Section 1(b). Thus, the Commission asserts that the Act's grant of authority under Section 7(b) to issue certificates authorizing jurisdictional sales and the grant of authority under Section 7(b) to control abandonment of such sales also somehow includes a grant of jurisdiction over production activities despite the Act's express denial of such jurisdiction under Section 1(b).

This precise argument was made by the Commission and rejected by this Court in *Panhandle.* The Court determined that the Commission's position would strip all meaning from the production exemption:

> "To accept these arguments springing from power to allow interstate service, fix rates, and control abandonment would establish wide control by the Federal Power Commission over the production and gathering of gas. It would invite expansion of power into other phases of the forbidden area. It would be an assumption of powers specifically denied the Commission by the words of the Act as explained in the report and on the floor of both Houses of Congress.[7]"

Just as this Court did in *Panhandle,* the Court below correctly rejected the Commission's attempt to negate the express language of the Gas Act excluding production activities from the Commission's jurisdiction.

Faced with the clear and unambiguous holdings in *Colorado Interstate* and *Panhandle,* the Commission in its petition suggests that, after the *Phillips* decision of 1954, this Court retreated from its prior determination in those cases that the Commission has no jurisdiction over the physical activities of production. The Commission also suggests that retreat began in the *Phillips* case. Both suggestions are erroneous.

[7] 357 U.S. at 509 (footnotes omitted).

First, the Commission cites no case and indeed there is no case in which this Court has given the slightest hint that the activities of production are subject to Commission jurisdiction. To the contrary, in 1965, some eleven years after *Phillips,* the Court stated that the production exemption encompasses "the physical activities, processes, and facilities of production. . . ."[8]

Nor does the *Phillips* decision in any way purport to be a departure from the Court's prior determination that the physical activities of production are not within Commission jurisdiction. To the contrary, the Court stated that its determination in *Phillips* was based on its prior interpretation of the production and gathering exemption. After discussing *Panhandle* and *Colorado Interstate,* as well as other cases, the Court concluded:

> "We see no reason to depart from our previous decisions, especially since they are consistent with the language and legislative history of the Natural Gas Act."[9]

This Court has consistently adhered to the Congressional mandate that production activities are not subject to the Commission's control.

The Commission also suggests in its Petition that failure to allow the Commission to regulate production activities would result in a "regulatory gap" in which production activities would be free from regulatory control. In fact, however, adherence to the statutory mandate precluding Commission jurisdiction over production activities does not mean such activities are unregulated. To the contrary, production is already regulated in the precise manner contemplated by Congress.

[8] *United Gas Improvement Co.* v. *Continental Oil Co.,* 381 U.S. 392, 402 (1965).

[9] 347 U.S. 681.

The basic purpose of the Gas Act was to bring within the jurisdiction of the Commission those natural gas related activities which, under the state of the law existing at the time the Act was passed, the states had no power to regulate. *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949). Thus the exemptions of Section 1(b) were designed to leave to the states regulation of matters over which the states did have power and which were therefore deemed to be of local concern. As stated in *Panhandle*, "The jurisdiction of the Federal Power Commission was to complement that of the state regulatory bodies."[10]

One of the areas reserved to the states and over which the states have and have always had authority is production of the mineral resources from lands located within state boundaries. *FPC* v. *Panhandle Eastern Pipe Line Co., supra; FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944). The states have established regulatory bodies which have both the expertise and the statutory authority to regulate production. *See, e.g.* TEX. REV. CIV. STAT. ANN. art. 6049c (1962).

With respect to the offshore Federal domain, Congress, under the Outer Continental Shelf Lands Act,[11] placed the regulation of offshore production in the hands of the Department of Interior, not the Commission. Interior discharges this statutory responsibility through the United States Geological Survey and has adopted regulations which cover in detail every aspect of production from offshore Federal domain acreage.[12] Those regulations provide, in essence, that the operator of an offshore lease must conduct operations as a prudent operator. 30 C.F.R. § 250.33(d).

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[10] 337 U.S. 504.

[11] 43 U.S.C. §§ 1331-1343.

[12] 30 C.F.R. §§ 250.1, *et seq.* Production from federal lands onshore is covered by the Federal Mineral Leasing Act, 30 U.S.C. §§ 181, *et seq.* (1971).

With the enactment in December, 1975 of the Energy Policy and Conservation Act (EPCA), Congress has once again made clear its determination that the regulation of development and production of gas reserves is a matter for the Department of the Interior and the states. Section 106 of the Act[13] deals with the precise area into which the Commission has intruded under Order 539-B. Section 106 provides that *Interior* shall determine the maximum efficient rate of production from fields containing gas reserves located on federal lands. The maximum efficient rate is that rate which can be sustained without loss of ultimate recovery of gas "under sound engineering and economic principles."[14] Under Section 106(a)(2)(A), the President may require gas production from federal lands at the maximum efficient rate established by Interior

The EPCA also deals with gas production from non-federal lands. Just as it was in the Gas Act, jurisdiction over such production was reserved to the states. Under Section 106(b)(1), the determination of a maximum efficient rate of production from non-federal lands is reserved to the discretion of the appropriate state regulatory bodies.

Thus Congress has determined not once, but twice, and most recently less than three years ago, that production activities on non-federal lands are to be regulated by the states. And Congress has not only expressly withheld from the Commission jurisdiction over production from federal lands, but has on two separate occasions granted jurisdiction of such matters to *Interior*. There is, therefore, no regulatory gap resulting from the Section 1(b) production exemption. Instead, regulation of production is being accomplished precisely as Congress intended.

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[13] 42 U.S.C. § 6214

[14] 42 U.S.C. § 6214(e)(1)

CONCLUSION

For the foregoing reasons Respondents Tenneco Oil Company and Pennzoil Company submit that the petitions for writs of certiorari should be denied.

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CERTIFICATE OF SERVICE

I hereby certify that I have served three copies of the Brief of Respondents Tenneco Oil Company and Pennzoil Company In Opposition on counsel of record for the other parties by depositing copies of it in the United States Mail, postage prepaid, on June 19, 1978.

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Nos. 77-1652 and 77-1654

In the Supreme Court of the United States

OCTOBER TERM, 1978

FEDERAL ENERGY REGULATORY COMMISSION,
PETITIONER

v.

SHELL OIL COMPANY, ET AL.

CONSUMER FEDERATION OF AMERICA,
ENERGY POLICY TASK FORCE,
PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-10a) is reported at 566 F.2d 536. The order of the Federal Power Commission (No. 539-B) (Pet. App. 13a-32a) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on January 20, 1978 (Pet. App. 11a-12a). By order of April 11, 1978, Mr. Justice Powell extended the time for filing a petition for a writ of certiorari in No. 77-1652 to May 20, 1978; the petition was filed on May 19, 1978, and was granted on October 2, 1978. By order of April 23, 1978, Mr. Justice Powell extended the time for filing a petition in No. 77-1654 to May 20, 1978, and the petition was filed on that date and was granted on October 2, 1978. The jurisdiction of this Court rests on 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Whether the "production or gathering" exclusion in Section 1(b) of the Natural Gas Act denies the Federal Energy Regulatory Commission authority to require certificated producers of natural gas to "observe the standard of a prudent operator" in developing and maintaining delivery of gas from their dedicated reserves.

STATUTES AND REGULATION INVOLVED

Sections 1(b), 7(b), (c), and (e) of the Natural Gas Act, 15 U.S.C. 717(b), 717f(b), (c), and (e), are set forth as an Appendix to this brief, *infra*, pp. 39-41.

Section 157.41 of the Commission's Rules and Regulations, 18 C.F.R. 157.41, provides:

> On and after July 30, 1976, all certificates of public convenience and necessity for the sale of natural gas for resale in interstate commerce shall be conditioned as follows:
>
> > All persons making jurisdictional sales pursuant to the authority granted by this certificate are hereby given notice that the contractual obligations between the buyer and the seller are incorporated into the certificate obligations, and that the certificate is further conditioned to require that the seller shall observe the standard of a prudent operator to develop and maintain deliverability from reserves dedicated hereunder.

STATEMENT

This case concerns the obligation of producers under the Natural Gas Act of 1938, 15 U.S.C. 717-717w, to supply gas in interstate commerce. On November 9, 1978, the Natural Gas Policy Act of 1978 ("NGPA"), Pub. L. No. 95-621, 92 Stat. 3352, was signed into law. The Natural Gas Policy Act alters the obligations of producers with respect to certain future sales of gas in interstate commerce, but, as we

shall explain (see pages 13-17, *infra*), the Natural Gas Act of 1938 will continue for many years to govern the non-price obligations of producers with respect to the overwhelming portion of the very large volumes of gas reserves that are presently dedicated to interstate commerce.

A. The Natural Gas Act of 1938

Under the Natural Gas Act of 1938, as construed by this Court in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), all producer sales of natural gas for resale in interstate commerce were subject to the requirements of Section 7 of the Act. A producer seeking to sell natural gas for resale in interstate commerce was required to obtain from the Federal Power Commission,[1] under Section 7(c) of the Act, 15 U.S.C. 717f(c), a certificate of public convenience and necessity. Under Section 7(e) of the Act, 15 U.S.C. 717f(e), the Commission could grant such a certificate only if it found "that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform" to the requirements of the Act and the Commission's rules and regulations, and if it further found that the proposed service "is or will be required by the present or future public convenience and necessity." Section 7(e) also authorized the Commission to attach to the

[1] Pursuant to the Department of Energy Organization Act, Pub. L. No. 95-91, 91 Stat. 565, the functions of the Federal Power Commission relevant to this case were transferred to the Federal Energy Regulatory Commission, effective October 1, 1977. We shall use the term "the Commission" to refer to either body, as the temporal context indicates.

certificate "such reasonable terms and conditions as the public convenience and necessity may require."

Once gas began to flow in interstate commerce from the sources covered by the certificate, that service could not be terminated except in accordance with the abandonment provision of Section 7(b) of the Act, 15 U.S.C. 717f(b). That provision states in pertinent part:

> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission * * * and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

Thus, as this Court has held in many cases, a certificate issued by the Commission dedicates to interstate commerce the reserves covered by the certificate, and a producer may not cease the service of supplying gas from those reserves to interstate commerce unless it obtains the Commission's permission for abandonment. It may not abandon that service unilaterally, and neither may it do so pursuant to a contract with its customers or lessors.[2]

[2] See, *e.g.*, *California* v. *Southland Royalty Co.*, No. 76-1114 (May 31, 1978); *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137 (1960). As those decisions reflect, the measure of the reserves dedicated by the certificate is usually the gas sale contract filed by the producer along with its certificate

B. The Proceedings Before the Commission

In a series of orders, Nos. 539, 539-A, and 539-B, the Commission has sought to define more specifically the obligation of certificated producers under the Natural Gas Act to deliver gas to their interstate customers from their dedicated reserves. As the Commission put it (Pet. App. 16a), the question it addressed was "what standard or test of deliverability the producer is required to live up to under the provisions of the Natural Gas Act and the rules and regulations of this Commission."

1. *Order No. 539*

In Order No. 539, issued October 14, 1975 (A. 2-14), the Commission noted that questions concerning the deliverability of dedicated reserves and the supply obligations of certificated producers had been raised both in congressional hearings and in the day-to-day administration of the Natural Gas Act (A. 2-3). It therefore undertook to state its policy on these questions in a declaration to be incorporated

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application. Thus, if Producer A sought a certificate to sell gas to Pipeline B, it would attach the gas sale contract to its proposed certificate, and the contract would typically call for the sale, at a certain price, of all gas produced from specified leases held by the producer. The reserves underlying those leases would thus become dedicated to interstate commerce. And unless the certificate was limited in time, those reserves would remain dedicated until the Commission authorized abandonment, notwithstanding any time limitation in the gas sale contract. See *Sunray, supra.*

into its regulations. This statement said, among other things, that as a condition of their certificates, producers have enforceable obligations under the Natural Gas Act with respect to the deliverability of certificated volumes of natural gas, whether or not such requirements were specifically included in the order granting the certificate (A. 11). The Commission further declared that certificates issued from then on should state a certificated minimum delivery obligation of the producer-seller, which would be derived from the gas sale contract but would disregard any contrary contractual reservations; this obligation would remain in effect until modified by amendment of the certificate (A. 13).

Producer and pipeline interests sought rehearing of Order No. 539. They contended, among other things, that the Commission had promulgated a substantive rule without complying with the rulemaking requirements of the Administrative Procedure Act; that Order No. 539 misinterpreted producer-pipeline contracts and existing certificate obligations, in that neither source provided for delivery obligations in specific quantities; and that the Commission was attempting to control activities excluded from its jurisdiction by the production or gathering exclusion of Section 1(b) of the Natural Gas Act, 15 U.S.C. 717 (b), which provides that the Act "shall not apply * * * to the production or gathering of natural gas" (*e.g.*, A. 16-26, 144-156).

2. *Order No. 539-A*

In Order No. 539-A, issued March 26, 1976 (A. 263-283), the Commission explained that it had only intended to make it clear that deliveries under certificated contracts must be maintained in accordance with the requirements of the contract and the certificate (A. 268-276). Nevertheless, the Commission noted the parties' objection "that gas sales contracts do not contain any deliverability obligations whatsoever" (A. 275). To eliminate uncertainty over certificated requirements, the Commission instituted a formal rulemaking proceeding, and it invited interested persons to address in written comments and oral arguments specific questions concerning delivery obligations (A. 272).

3. *Order No. 539-B*

That rulemaking proceeding produced the order at issue here. Producers argued in the proceeding that gas sale contracts do not require producers to deliver any specific quantity of gas (*e.g.*, A. 20-21, 331-335, 348-349, 374-376). They contended that under the typical contract the production of gas remains in the sole discretion of the producer, subject only to the producer's obligations to operate reasonably and prudently—obligations owed to its lessors under covenants in its lease, and imposed also by state[3] or

[3] See, *e.g.*, La. Rev. Stat. Ann. § 30:4 *et seq.* (West 1975); Okla. Stat. Ann. title 52, § 274 (West 1969); Tex. Rev. Civ. Stat. Ann. art. 6049c *et seq.* (Vernon 1962).

federal[4] conservation requirements.[5] The producers claimed that gas purchasers normally have no contractual remedy for a producer's failure to develop production from acreage subject to a gas sale contract, and that the Commission had no authority to require or enforce any delivery obligation under such contracts; the Commission could only prohibit the total abandonment of service or prevent diversion of dedicated gas to another purchaser (*ibid.*). Any attempt by the Commission to assure continued delivery of dedicated reserves would involve the Commission in the "production or gathering" of natural gas, which Section 1(b) of the Natural Gas Act places

[4] On the Outer Continential Shelf, the requirements are defined by the United States Geological Survey, an agency within the Department of the Interior. See Outer Continental Shelf Lands Act, 43 U.S.C. 1331 *et seq.*; 30 C.F.R. Part 250 *et seq.*; 43 C.F.R. Part 3300; OCS Orders Nos. 1-12, governing oil, gas, and sulfur leases to the Outer Continental Shelf, Gulf of Mexico area, U.S.G.S. Conservation Division, January 1975 (Pet. App. 20a).

[5] The producers took the position that they were already subject to a prudent operator standard derived from state law governing oil and gas leases and from state statutes governing conservation and correlative rights (A. 331-333, 346, 370-372). They also argued that they were constrained by the technology of reservoir engineering, which teaches that reservoir production initially may exceed the capacity of pipelines to transport and market the gas, but gradually declines below pipeline capacity levels. See, *e.g.*, A. 167-170, 123, 346, 352. See generally 1 H. Williams & C. Meyers, *Oil & Gas Law*, ch. 1 (1977 ed.). See also Interstate Oil Compact Commission, *A Study of Conservation of Oil and Gas in the United States* 12-74 (1964). See also discussion *infra*, pages 31, 32-33 and note 19.

beyond its jurisdiction (A. 151-152, 178-184, 187-188, 331, 348-351, 402, 403, 410).

The position taken by pipelines in the proceeding was somewhat different. While they generally agreed with the producers that gas sale contracts do not typically set forth any specific minimum delivery obligations, they asserted that purchasers nevertheless have contractual rights to require producers not to cease deliveries arbitrarily or because of a failure to operate with reasonable prudence (A. 454-455, 462-463).

The Consumer Federation of America took the position that existing certificates set forth specific and enforceable delivery obligations (A. 305, 321, 454-455, 463).

After considering these arguments, the Commission, on July 30, 1976, issued its Order No. 539-B, adopting the policy at issue here. It ruled that existing certificates are subject to an implied requirement, and that new certificates would be expressly conditioned to require, that "the seller shall observe the standard of a prudent operator to develop and maintain deliverability from reserves dedicated [under the certificate]" (Pet. App. 24a; 18 C.F.R. 157.41).

The Commission adopted the "prudent operator" standard, in preference to its earlier concept of "certificated minimum daily delivery obligation," because it found that the latter did not have a generally accepted meaning among producers and pipelines (Pet. App. 14a-15a). In contrast, it found that the standard of a "prudent operator" is well-known in the in-

dustry, and to producers in particular, since it is reflected in lease agreements and in the requirements of state and federal regulatory agencies (*id.* at 19a). The Commission stated: "This standard encompasses the obligations to develop the properties consistent with the performance requirements of lease agreements with mineral owners and/or assignors; all valid rules and regulations of any Federal, state or local government having jurisdiction; and the standard of what a reasonably prudent producer would do with respect to the drilling[,] completion, workover, recompletion or abandonment of wells." *Id.* at 20a.

The Commission observed that some parties to its proceeding had advanced the argument "that a common term in producer-pipeline contracts called the 'sole discretion' clause permits the producer complete control over deliverability to the pipeline" (*id.* at 15a-16a). But the Commission insisted that "its certificate conditions, and the incidents of service which [they] represent[], are superior to any limitations on Commission authority contained in the contract" (*ibid.*).

The Commission rejected the producers' contention that the production or gathering exclusion in Section 1(b) denies it authority to enforce deliverability obligations as a condition to certificates. It reasoned, citing *Phillips Petroleum Co.* v. *Wisconsin*, *supra*, that sales for resale in interstate commerce are outside the production or gathering limitation. Under *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137 (1960), and other decisions, once a contract has been certificated, its

obligations must be performed in accordance with the requirements of the Natural Gas Act. Since each certificated contract is subject to the abandonment provisions of Section 7(b) of the Act, the Commission declared that "[i]f the seller under a certificate is not meeting the delivery obligations of such certificate, there has been either a partial or total abandonment of certificated service which requires Commission approval pursuant to Section 7(b)" (*id.* at 23a).

The Commission found that it had authority "to preserve the integrity of its certification process by conducting an oversight review of an on-going service obligation" (*id.* at 18a). Compliance with delivery obligations was to be enforced by determining whether the natural gas company had acted prudently in the circumstances. Such a standard, the Commission ruled, was implicit in the service obligation incorporated into all existing certificates under *Sunray, supra.* The Commission further concluded that it should adopt a regulation making this "prudent operator" obligation explicit and incorporating it expressly in all future certificates (*id.* at 24a).

C. The Decision of the Court of Appeals

Respondents in No. 77-1652, the Shell Oil Company and other producers of natural gas, petitioned for review of Order No. 539-B, contending that it exceeded the Commission's authority under Section 1(b) of the Natural Gas Act. Petitioners in No. 77-1654, Consumer Federation of America (CFA), also petitioned for review, claiming that the "prudent

operator" standard was inadequate to assure fulfillment of certificated delivery obligations.

Agreeing with the producers, the court of appeals vacated and remanded the order (Pet. App. A).

The court held that establishment of the prudent operator requirement was placed beyond the Commission's jurisdiction by the production or gathering exclusion in Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b). The court reasoned that even though the Commission may enforce producers' service obligations by "preventing producers from ceasing deliveries from fields admittedly capable of continuing production," and even though it may regulate abandonments, the Commission's jurisdiction may not be extended "directly into the physical activities, processes, and facilities of production and development" (*id.* at 7a). In the court's view, Order 539-B was such an extension, and the Order was held invalid because it "clearly is intended to open the door to FERC involvement into forbidden production activities" (*id.* at 8a). Stating that to uphold the order "would all but eliminate the 'production or gathering' exclusion and would allow the FERC to encroach on areas reserved to the states," the court declared the order to be beyond the Commission's jurisdiction (*id.* at 9a).[6]

D. The Natural Gas Policy Act of 1978

On November 9, 1978, the Natural Gas Policy Act of 1978 ("NGPA"), Pub. L. No. 95-621, 92 Stat. 3352

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[6] Having held that the Commission's order exceeded its jurisdiction, the court did not reach CFA's claim that the order did not go far enough (see *id.* at 10a n.6).

was signed into law. Three principal features of that Act are pertinent to the issues in this case: [7]

1. Under Sections 101-110 of the NGPA, all sales of natural gas after December 1, 1978, will be subject to rate ceilings established by the Act itself, and not (except in certain circumstances) to rates established by the Commission. Section 101(b)(4)(C). The Act establishes different ceiling prices for different categories of gas; it applies to all wellhead sales of gas, whether in interstate or intrastate commerce, including gas sold under existing intrastate contracts (Sections 105 and 106(b)).[8] Under Section 101(b)(9),

[7] Copies of the Act and of the Conference Report, H.R. Conf. Rep. No. 95-1752, 95th Cong., 2d Sess. (1978), are being lodged with the Clerk of the Court.

What follows in the text is a general description of certain features of a complex statute. It constitutes only an initial view, which may be modified by the Commission in the light of further experience and consideration.

[8] In the main, ceiling rates for sales of gas already dedicated to interstate commerce will be based on the Commission's established ceiling rate applicable to the gas involved on April 20, 1977, adjusted upward for inflation. Sections 104, 106(a). The Act specifies ceiling rates for numerous other categories of gas. For example, "new natural gas" (defined in Section 102(c)) will be subject to a ceiling rate of $1.75 per million Btu's, adjusted upward for inflation and a growth factor from April 1977. Section 102(b). Gas sold under existing intrastate contracts will be subject to the rate specified in the contract, but no higher than the "new natural gas" price if the contract price is initially lower than the "new natural gas" price. Section 105(b). The Act's pricing provisions are subject to certain other exceptions and qualifications. The Act also provides for eventual deregulation, after January 1, 1985, of rates for certain categories of gas. Section 121.

the prices specified in the Act are only ceilings, and they do not nullify or supersede lower prices specified in contracts.

2. The NGPA expressly codifies the concept, established by decisions under the Natural Gas Act, of natural gas that is "committed or dedicated" to interstate commerce, and it provides that future sales of gas that was so dedicated before November 8, 1978, will remain subject to the provisions of the Natural Gas Act (save for the Commission's rate-regulating jurisdiction, and with certain categories of gas excepted). Sections 2(18), 601(a) of the NGPA.[9] Future sales of gas from reserves so dedicated will therefore remain subject to the conditions of certificates previously issued under Section 7(e), and to the requirement of Section 7(b) that the service of supplying gas from such reserves may not be abandoned without the Commission's approval.

3. Future sales of gas from reserves that were not dedicated to interstate commerce before November 8, 1978, generally will not be subject to the requirements of the Natural Gas Act. Section 601(a) of the NGPA. Thus, sales of such gas will not require a certificate from the Commission under Section 7 of the

[9] Section 601 of the NGPA excludes certain categories of previously dedicated gas from the Commission's jurisdiction under the Natural Gas Act; among those categories are "high-cost gas," defined in Section 107(c); "new natural gas," defined in Section 102(c); natural gas produced from any "new, onshore production well," defined in Section 103(c); and gas sold under Section 6 of the Emergency Gas Act of 1977, Pub. L. No. 95-2, 91 Stat. 4. See also page 37, note 28, *infra*.

Natural Gas Act, and will not be subject to the abandonment provision of Section 7(b).

The principal issue in this case is whether the Natural Gas Act imposes an obligation on certificate holders, which the Commission has jurisdiction to enforce, that they act as reasonably prudent operators in maintaining deliveries to interstate commerce of gas from dedicated reserves. That issue will continue to be significant for many years with respect to the overwhelming portion of the vast quantity of gas now dedicated to interstate commerce. As of December 31, 1977, approximately 92.6 Tcf (trillion cubic feet) of gas,[10] out of currently estimated total remaining recoverable reserves in the United States of 208.8 Tcf,[11] were covered by certificates issued for interstate sales of natural gas under the Natural Gas Act.[12] The validity of Order 539-B as applied to existing certificates thus remains a question that will affect an enormous quantity of gas for the indefinite future.[13]

[10] Compiled from FERC Form No. 15 (18 C.F.R. 260.7), which is submitted annually by all jurisdictional gas pipeline companies. No firm estimates of the amount of previously dedicated gas that is specifically exempted by the NGPA from the non-price regulation provisions of the Natural Gas Act (see note 9, *supra*) are known to the Commission.

[11] *Reserves of Crude Oil, Natural Gas Liquids, and Natural Gas in the United States and Canada as of December 31, 1977*, Vol. 32, p. 112 (June 1978), prepared by the American Petroleum Institute, American Gas Association and Canadian Petroleum Association.

[12] The annual consumption of gas in the interstate market has varied; in 1977 it was 10.2 Tcf. See note 11, *supra*.

However, that part of Order 539-B that requires the prudent operator standard to be expressly incorporated in new certificates issued by the Commission will have no significance under the Natural Gas Policy Act, since sales of gas from reserves not dedicated on November 8, 1978, will not require certificates from the Commission.[14]

SUMMARY OF ARGUMENT

1. The Commission has authority under the Natural Gas Act to require certificated producers to take reasonable measures to develop and maintain delivery of gas from their dedicated reserves. The authority follows from this Court's decisions, particularly *Phillips Petroleum Co.* v. *Wisconsin, supra; Sunray Mid-*

[13] In enacting the Natural Gas Policy Act, Congress explicitly declined to express a view on the validity of Order No. 539-B as applied to existing certificates. In commenting on Section 315 of the NGPA, which authorizes the Commission to specify the duration of the contracts and to provide for a right of first refusal with respect to certain previously dedicated gas, the Conference Report noted that: "The conferees do not intend anything in this section, or anything in this Act, to prejudge the outcome of *Shell Oil* v. *FERC*, No. 76-3066 (5th Cir. Jan. 30, 1978), currently pending before the Supreme Court on the question of the extent of the Commission's jurisdiction over producer performance standards." (H.R. Conf. Rep. No. 95-1752, 95th Cong., 2d Sess. 111 (1978).

[14] This part of Order 539-B is applicable, however, to certificates issued by the Commission from July 30, 1976 (the date of the Order) to November 8, 1978 (the cut-off date under NGPA).

Continent Oil Co. v. *FPC*, 364 U.S. 137 (1960); and *California* v. *Southland Royalty Co.*, No. 76-1114 (May 31, 1978). Those cases have established that when the Commission issues a certificate under Section 7(e) of the Act, what it certificates is not only a sale, but a continuing obligation to deliver gas from dedicated reserves to interstate commerce until the Commission authorizes abandonment under Section 7(b). Unless the Commission has authority to enforce that obligation, the requirements of the Act are hollow.

2. The court of appeals concluded that the Commission has no such authority because delivery obligations involve a physical process and are therefore placed outside the Commission's jurisdiction by the provision of Section 1(b) that excludes from the application of the Act "the production or gathering of natural gas." The court was wrong. As *Phillips* and other cases establish, the production or gathering exclusion in Section 1(b) was not intended to override that Section's affirmative grant of jurisdiction to the Commission. It was intended to make it clear that the Natural Gas Act does not preempt state regulation of aspects of the natural gas business that are local in character, such as state laws regulating the production or gathering of gas in the interests of conservation, safety, or health. The exclusion was not intended to disable the Commission from enforcing the obligations of the Act whenever those obligations could be said to involve a physical process, such as the delivery of gas.

3. In defining the delivery obligations of certificated producers by the standard of a reasonably prudent operator, the Commission made a reasonable interpretation of the requirements of the Natural Gas Act. The prudent operator standard is a flexible one that gives producers ample latitude while preserving the ultimate authority of the Commission to prevent unauthorized de facto abandonments of certificated service. It is also consistent with legitimate state regulatory requirements. Indeed, it is to be administered with reference to such requirements, and constitutes the very standard under which producers claimed they were required by state law to operate.

Whether producers in fact have incentives to withhold deliveries of dedicated gas is irrelevant to the correctness of the Commission's statement of producers' obligations and to the authority of the Commission to enforce those obligations if necessary. The Commission's order was not based on a finding that producers were withholding gas, but was designed to clarify expressed uncertainties regarding the existence and scope of producers' delivery obligations under the Natural Gas Act. The Commission's proceedings confirmed those uncertainties.

The need for a familiar and workable standard defining producers' delivery obligations will continue for many years under the Natural Gas Policy Act of 1978. Under that Act, the provisions of the Natural Gas Act (including Section 7) will continue to apply, in general, to sales of gas from reserves dedicated before November 8, 1978, and such reserves are a

large part of this country's total estimated reserves. Indeed, the uncertainty of the economic incentives created by the new Act makes it particularly important that the Commission not be disabled from taking action to assure delivery of dedicated reserves if necessary. Moreover, the Commission's ability to enforce delivery obligations with respect to such reserves is consistent with the expectation of Congress, embodied in the Natural Gas Policy Act, that continued supplies of gas from such reserves would serve to mitigate the increase in gas prices to interstate consumers in the early years of the new Act.

ARGUMENT

THE COMMISSION HAS AUTHORITY UNDER THE NATURAL GAS ACT TO REQUIRE CERTIFICATED PRODUCERS TO DEVELOP AND MAINTAIN DELIVERY OF GAS FROM THEIR DEDICATED RESERVES BY THE STANDARD OF A PRUDENT OPERATOR

A. The Service Obligation Assumed by Certificated Producers Under Section 7 Implies a Standard of Deliverability, Which May Be Enforced By The Commission.

It is well established under the Natural Gas Act that the Commission's jurisdiction extends to producers who sell natural gas for resale in interstate commerce. *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954). It is also well established that a producer (or any other certificated natural gas company) has an obligation under the Natural Gas Act to continue the service of delivering gas from the dedicated reserves

to the certificated purchaser until the Commission, under Section 7(b) of the Act, permits abandonment of that service. *Sunray Mid-Continent Oil Co.* v. *FPC*, *supra*; *California* v. *Southland Royalty Co.*, *supra*. This obligation is superior to any contractual obligation the producer may have. *Sunray*, *supra*, 364 U.S. at 155-156; *Southland*, *supra*, slip op. 6.[15]

In short, under this Court's cases, what is certificated under the Natural Gas Act is not simply a sale, but a continuing obligation to deliver gas from dedicated reserves to interstate commerce.

The Commission's ability to ensure that producers (and other certificated sellers) continue deliveries from dedicated reserves follows, we submit, from the requirements of the Natural Gas Act and the Commission's jurisdiction to enforce those requirements.

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[15] In Section 2(18)(B)(iii) of the Natural Gas Policy Act, Congress has provided a retrospective exemption from the rule of the *Southland* case by excluding from the definition of gas "committed or dedicated to interstate commerce" gas that has been dedicated by a lessee of acreage which reverted to the lessor on or before May 31, 1978, and from which no gas was flowing in interstate commerce on that date. But the principle and the holding of *Southland* were not rejected. On the contrary, the holding is incorporated in Section 2(18)'s definition of gas "committed or dedicated to interstate commerce" and thus it applies to gas covered by existing certificates, with the exclusion in 2(18)(B)(iii) limited to gas that was not subject to a certificate on May 31, 1978. (The Conference Report states that the exclusion "limits further extension of the holding of the Supreme Court in *California et al.* v. *Southland Royalty Co. et al.* * * *. The case is not, however, reversed on its facts." H.R. Conf. Rep. No. 95-1752, *supra*, at 71 (citation omitted); see *id.* at 71-72.)

If a certificated producer unreasonably shuts in its wells or otherwise unreasonably reduces production; or fails to take prudent steps to maintain its equipment, so that production and delivery cease through simple neglect; or fails to develop its dedicated properties in accord with the requirements of its leases and applicable state law, it has effectively abandoned service without the Commission's approval. The Commission must have power to prohibit such acts or omissions, else the requirements of the Act, and Section 7(b) in particular, would be meaningless. Unless the Commission can define and control delivery obligations, producers would be able, through their dominion over physical operations, to determine for themselves whether and when to undertake a partial abandonment of services by suspending production. As this Court said in the *Permian Basin Area Rate Cases*, 390 U.S. 747, 777 (1968): "'[C]onsiderations of feasibility and practicality are certainly germane' * * *. We cannot, in these circumstances, conclude that Congress has given authority inadequate to achieve with reasonable effectiveness the purposes for which it has acted." On the contrary, "[t]his Court has repeatedly held that the width of administrative authority must be measured in part by the purposes for which it was conferred." *Id.* at 776.

B. The Production Or Gathering Exclusion In Section 1(b) Does Not Foreclose Enforcement of Deliverability Standards Based on Established Concepts of Prudent Operation.

Respondents nevertheless contend, and the court of appeals agreed, that the Commission has no power to enforce producers' delivery obligations under the Act because the delivery of gas involves a physical process and is therefore part of the "production or gathering of natural gas," to which Section 1(b) states that the Act does not apply. Thus, the court declared that to uphold Order No. 539-B "would all but eliminate the 'production or gathering' exclusion" (Pet. App. 9a). There is no merit to this position, which, if sustained, would seriously impair the Commission's ability to carry out its continuing responsibilities under the Natural Gas Act.

The court of appeals was wrong in considering the production or gathering exclusion apart from the affirmative grant of jurisdiction in Section 1(b), and in assuming that the exclusion was intended by Congress to override what would otherwise be an affirmative grant of jurisdiction.[16] The intended relationship

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[16] Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b), reads in full:

> (b) Transactions to which provisions of chapter applicable
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> The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall

between the affirmative and negative branches of Section 1(b) was considered by this Court in the *Phillips* case, *supra*, 347 U.S. at 679 n.7. The Court there described and quoted the Committee Reports on the Natural Gas Act:

> The committee reports on the bill enacted as the Natural Gas Act, H. R. 6588, 75th Cong., 1st Sess., reveal that a construction of the "production or gathering" exemption which would substantially limit the affirmative grant of jurisdiction to the Commission was not contemplated. After quoting the exemptive clause of 1(b), the House Report states that:
>
> > "The quoted words are not actually necessary, as the matters specified therein could not be said fairly to be covered by the language affirmatively stating the jurisdiction of the Commision, but similar language was in previous bills, and, rather than invite the contention, however unfounded, that the elimination of the negative language would broaden the scope of the act, the committee has included it in this bill." H. R. Rep. No. 709, 75th Cong., 1st Sess. 3.
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> The Senate Report adopted and reprinted the House Report on the bill. S. Rep. No. 1162, 75th Cong., 1st Sess.

Thus, the production or gathering exclusion was not intended to "substantially limit the affirmative

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not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

grant of jurisdiction to the Commission," and the exclusions in Section 1(b) were considered superfluous because the matters they specified were not within the terms of the affirmative grants. The relevant and complete inquiry here, then, is whether the Commission's action came within one of the affirmative grants of jurisdiction. If it did, the inference is that it was not within one of the exclusions. So if the Commission's jurisdiction over transportation and sales for resale in interstate commerce includes an ability to ensure that certificated producers continue deliveries from their dedicated reserves, as we have argued in Part A, *supra*, this ability is not destroyed by the production or gathering exclusion.[17]

Moreover, when there does appear to be an overlap between the affirmative grant of jurisdiction in Section 1(b) and the production or gathering exclusion, this Court has made clear how the apparent conflict should be resolved, and why. In *Interstate Natural Gas Co.* v. *FPC*, 331 U.S. 682 (1947), where sales found to be in interstate commerce were claimed to fall within the production or gathering exclusion, the Court posited that "[e]xceptions to the primary grant

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[17] Since the court of appeals conceded that the Commission "can enforce 'service obligations' contained in the certificates that it issues to producers, preventing producers from ceasing deliveries from fields admittedly capable of continuing production" (Pet. App. 7a), that should have been the end of the inquiry. The court erred—and disregarded what this Court said in *Phillips*, *supra*, 347 U.S. at 679 n.7, quoted at page 24, *supra*—by going on to hold that, nevertheless, the conceded jurisdiction was substantially curtailed by the production or gathering exclusion.

of jurisdiction in the section are to be strictly construed" (*id.* at 690-691). The Court went on to hold that since the sales were in interstate commerce, "[i]t cannot be doubted that their regulation is predominantly a matter of national, as contrasted to local concern," and that accordingly they were within the Commission's jurisdiction (*id.* at 692-693). As the Court subsequently explained, in deciding the *Interstate* case it "refused to rely on such refinements" as the claim that the gathering of the gas had already been completed at the time of the transportation or sale, but rather "based its decision in *Interstate* on the broader ground that sales in interstate commerce for resale by producers to interstate pipeline companies do not come within the 'production or gathering' exemption." *Phillips, supra*, 347 U.S. at 680-681.

In the *Phillips* case itself, where the Court held that wellhead sales by producers for resale in interstate commerce were subject to the Commission's jurisdiction, it rejected the claim that such sales were excluded by Section 1(b) because they were assertedly "an integral part" of the business of producing or gathering gas. 347 U.S. at 681. The Court quoted its statement in *Interstate* that " '[e]xceptions to the primary grant of jurisdiction * * * are to be strictly construed,' " and further noted, as mentioned earlier, that the Committee Reports on the Act "reveal that a construction of the 'production or gathering' exemption which would substantially limit the affirmative grant of jurisdiction to the Commission was not contemplated." *Id.* at 679 & n.7.

The Court applied the same principles in *United Gas Improvement Co.* v. *Continental Oil Co. (Rayne Field)*, 381 U.S. 392 (1965). In holding there that the Commission had jurisdiction over sales of gas still in the ground (that is, sales of leaseholds), the Court rejected the argument that the timing of those sales (before the gas was "produced") placed them within the production or gathering exclusion and hence beyond the Commission's jurisdiction. The Court stated (381 U.S. at 402):

> Acceptance of any such narrow interpretation would make *Phillips* a shadow. Its substance lies, instead, in the judgment that "[p]rotection of consumers against exploitation at the hands of natural-gas companies was the primary aim of the Natural Gas Act," [347 U.S.] at 685, and "congressional intent [was] to give the Commission jurisdiction over the rates of all wholesales of natural gas in interstate commerce." *Id.*, at 682.

The Court thus held (381 U.S. at 402):

> We conclude that even though a sale of natural gas in interstate commerce occurs before production or gathering is ended, it is nonetheless subject to regulation.

The Court went on to explain (*id.* at 402-403):

> In the context of such a sale, * * * the "production or gathering" exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdic-

> tion. This accommodation of the two relevant clauses of § 1(b) gives content to the national objectives of the Natural Gas Act as expounded in *Phillips*, and to the Commission's jurisdiction to accomplish them, while in no way interfering with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate state concerns.

Thus, as interpreted by the Court in *Rayne Field*, the production or gathering exclusion was intended to save state regulatory power over the physical processes of production or gathering for the purposes of conservation or other legitimate state concerns, but not to limit the Commission's power to enforce the requirements and secure the "national objectives" of the Act. The exclusion does not relate "to sales of the kind affirmatively subjected to Commission jurisdiction" (*ibid.*).

The same principle is reflected elsewhere in the legislative history of the Act. Thus, the report of the House Committee on Interstate and Foreign Commerce on the bill that became the Natural Gas Act (H.R. Rep. No. 709, 75th Cong., 1st Sess. 1-2 (1937)) stated:

> [I]n the case of sales for resale, or so-called wholesale sales, in interstate commerce (for example, sales by producing companies to distributing companies) the legal situation is different. Such transactions have been considered to be not local in character and, even in the absence of Congressional action, not subject to State regulation. (See *Missouri* v. *Kansas Gas Co.* (1924), 265 U.S. 298, and *Public Utilities Commission* v. *Attleboro Steam & Electric Co.* (1927) 273 U.S. 83.) The basic purpose of the present legislation is to occupy this field in which the Supreme Court has held that the States may not act.

In sum, this Court's decisions and the legislative history establish that Congress' purpose in the Natural Gas Act "was to take over where the States' power ceased, following the chain of distribution back to the interstate market * * *. But, once begun, prevention of the circumvention of such regulation virtually compelled extension of control to the source." *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 302 n.23 (1974). The production or gathering exclusion was designed to make clear that the Natural Gas Act was not intended to preempt state regulation of activities essentially "local in character"—regulation in furtherance of such traditional state concerns as conservation or health and safety. It was not intended to disable the Commission from enforcing the obligations of the Act whenever those obligations could be said to involve some physical process, such as the delivery of gas.

The exclusion did not have the mechanistic purpose of dividing federal and state jurisdiction on the basis of whether an act or transaction involved some physical process. Rather it had the functional purpose, grounded at once in the "national objectives" of the Act and in considerations of federalism, of saving traditional state jurisdiction over matters that are

"local in character" and that do not impinge on the jurisdiction necessarily given the Commission.

To conclude, as the court of appeals did, that the Commission has no power to enforce the statutory obligations of producers to continue the service of delivering gas from dedicated reserves, because those obligations touch on the physical production process, would indeed "make a shadow" of *Phillips*, as well as other decisions of this Court and Section 7 of the Act. The production or gathering exclusion works no such eviscerating result.

C. The Commission's Prudent Operator Standard Constitutes A Reasonable Interpretation of the Requirements of the Natural Gas Act, Is Consistent with State Regulatory Requirements, and Accords with the Purposes of the Natural Gas Policy Act of 1978.

The court of appeals held that the Commission has no jurisdiction to require producers to comply with the prudent operator standard in delivering gas from dedicated reserves—or, presumably, with any other standard—because such delivery involves the physical process of production. The court therefore did not consider whether the prudent operator standard was substantively consistent with the purposes of the Natural Gas Act. Respondents, however, have argued that the prudent operator standard is not reasonable and will place the Commission in conflict with state regulatory authorities. We therefore will briefly address those contentions.

The prudent operator standard is reasonable. In Order No. 539-B the Commission accepted the producers' claim that it would be impracticable to utilize specific quantitative delivery requirements (Pet. App. 14a-15a). Instead, the Commission adopted a flexible standard giving producers reasonable latitude while preserving the ultimate authority of the Commission to prevent unauthorized de facto abandonments of certificated service.

Far from conflicting with legitimate state regulatory requirements, the prudent operator standard expressly encompasses those requirements and constitutes the very standard under which the producers claimed they were already operating.[18] Thus, the Commission stated (Pet. App. 20a; footnote omitted):

> This standard encompasses the obligations to develop the properties consistent with the performance requirements of lease agreements with mineral owners and/or assignors; all valid rules and regulations of any Federal, state or local government having jurisdiction; and the standard of what a reasonably prudent producer would do with respect to the drilling[,] completion, workover, recompletion or abandonment of wells.

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[18] See Shell Br. In Opp. at 6: "Producers have long recognized their obligation to develop and produce their leases in a diligent manner, and in accordance with what is described as the 'ordinary prudent operator' test." See also A. 24, 126-128, 145-148, 152-153, 155, 289-301, 331, 343, 346, 354, 401-404.

This standard does not imply federal obligations different from those imposed by the states either under the terms of leases or under state conservation laws. On the contrary, it is to be administered with reference to those state standards. The Commission's standard simply requires that the producer operate in accordance with established practice and with requirements adopted by the jurisdiction exercising direct regulation over the production.[19] Application of

[19] As this Court has stated, oil and gas production "touch-[es] matters of geography and geology and physics and engineering." *Railroad Commission of Texas* v. *Rowan & Nichols Oil Co.*, 310 U.S. 573, 583 (1940). See also *Champlin Refining Co.* v. *Corporation Commission of Oklahoma*, 286 U.S. 210, 228 (1932). Most producing states have enacted conservation laws to regulate the correlative rights of leaseholders through unitization of reservoirs, well spacing requirements, allocation of production through proration systems that determine the amount of oil or gas each well will be allowed to produce, and requirements governing the ratios between gas, oil, and water that determine the pressures by which gas and oil can be forced to the surface through a well. Such measures have been sustained on the ground that the state may constitutionally conserve scarce resources and prevent unfair and discriminatory production by some wells at the expense of others. *E.g. Champlin Refining Co., supra; Northern Natural Gas Co.* v. *State Corporation Commission of Kansas*, 372 U.S. 84, 103 (Harlan, J., dissenting) (1963).

In addition, mineral leases have been held by state courts to imply certain covenants, including covenants to take reasonable measures to develop the premises, to market the product, and to conduct with reasonable care and due diligence all operations on the leasehold that affect the lessor's royalty interest. These implied covenants are the elements of what has customarily been described in the industry as the prudent operator standard. The cases and authorities are collected in 5 H. Williams & C. Meyers, *supra*, at Sections 804, 806-808.

the prudent operator standard to particular cases will depend on the circumstances, but state law or United States Geological Service regulations will ordinarily provide the specific contents of the standard and hence the yardstick against which the producer's performance is measured.

Application of the prudent operator standard to particular cases is not at issue here.[20] What is at issue is simply the Commission's authority to adopt this standard, or any other, to define and enforce the obligation of producers under the Act to operate their facilities so as to deliver the gas they committed themselves to deliver when they obtained a certificate from the Commission.

[20] A spectrum of cases can be posited. At one end is the producer that temporarily shuts in its wells in the hope that higher gas prices will be obtained later, or that deliberately fails to maintain its production facilities properly and then claims it is unable to honor its delivery obligations. At the other end may be cases in which production can be maintained only by drilling additional wells or by taking affirmative measures to maintain pressure in the reservoir. In determining what is prudent, cases of the latter sort would be judged by reference to state or U.S.G.S. production requirements, as Order No. 539-B indicates (Pet. App. 20a).

Application of the prudent operator standard may also require in certain cases a balancing of the costs of affirmative measures against the service obligation in the light of applicable regulatory price ceilings. The Commission confronted this problem in connection with the area and national rate ceilings it developed under the Natural Gas Act. See Policy With Respect To Rates Where Reduced Pressures, Need For Reconditioning, Deeper Drilling, Or Other Factors Make Further Production Uneconomical At Existing Prices (18 C.F.R. 2.76).

Respondents have also argued that the Commission's prudent operator standard is based on the incorrect premise that producers have an incentive to reduce or cease production and delivery of dedicated gas. Respondents claim that considerations of geology and economics provide ample incentives for producers to maintain production and delivery, and that state laws already require them to do so prudently.[21]

This argument is beside the point. Order No. 539-B was based not on a finding that producers had been withholding deliveries of dedicated gas, but on the Commission's interpretation of the Act.[22] Respondents' argument asserts only that the Commission's statement of what the Act requires of producers is, as a practical matter, unnecessary, because producers have other reasons for complying with those requirements. The argument does not show that the Commission's statement of the law is incorrect, as the court of appeals held it to be.[23]

Moreover, the Commission did have reasonable grounds for believing that a statement of producers' delivery obligations under the Natural Gas Act was needed. As we noted earlier (page 6, *supra*), the

[21] See Shell Br. in Opp. at 3-4.

[22] See *Abbott Laboratories* v. *Gardner*, 387 U.S. 136, 149 (1967); *Gardner* v. *Toilet Goods Association, Inc.*, 387 U.S. 167, 170-171 (1967); *Chisholm* v. *FCC*, 538 F.2d 349 (D.C. Cir. 1976), cert. denied, 429 U.S. 890 (1976).

[23] If Order No. 539-B is unnecessary, the Commission happily will not be called on to enforce it, and producers—including the 34 producers who are respondents in this case—will not have been adversely affected by it.

very reason the Commission instituted these proceedings was to resolve uncertainties that had arisen, and the proceedings themselves only highlighted the wide differences of opinion on the subject. Some producers insisted that under their certificated gas sales contracts they had no obligation that could be enforced by their purchasers, or the Commission, to deliver any gas whatever—*i.e.*, that they could terminate deliveries at will.[24] Other producers took a possibly different view,[25] and the position of the pipelines differed further.[26] Other parties, such as the Consumer Federation of America, insisted that the producers

[24] Thus, for example, counsel representing Tenneco and certain other producers asserted that under typical gas sales contracts, producers had no obligation that could be enforced by the purchasing pipeline or the Commission to deliver any amount of gas (A. 408-409, 432-433). He asserted that producers may have obligations to their lessors under lease provisions and state law to operate prudently, but that only the lessors could legally enforce those obligations (*ibid.*).

[25] Counsel representing Shell and certain other producers appeared to agree with the position stated by counsel for Tenneco (A. 408-409); but he also stated (A. 399):

> I think * * * the producers have a delivery obligation under their contracts, and that obligation is to deliver the gas from the field or reservoir committed to that contract.
>
> But the rate of delivery is something else again.

[26] The counsel for an association of pipelines asserted that gas sale contracts did not set forth any specific daily minimum delivery obligation, but that pipeline purchasers and the Commission did have a right to enforce deliveries if the producer was not operating prudently (A. 454-455; see also A. 463).

were obliged to maintain daily deliveries of specific volumes of gas.[27] The Commission's eventual statement of policy and accompanying rule were designed to resolve those questions by providing a workable, familiar, and understandable criterion for delivery requirements under both existing and future certificates.

The need for such a standard with respect to existing certificates will continue for many years under the Natural Gas Policy Act of 1978. As noted earlier (pages 15-17, *supra*), Section 2(18) 601(a) of the Act show that the Natural Gas Act (including Section 7) will continue to apply to future sales of gas from reserves previously dedicated, and such gas constitutes a substantial portion of estimated United States reserves.

Whatever financial incentives to reduce or terminate interstate deliveries may have been generated by the price regulating mechanisms of the Natural Gas Act (see Pet. 10) are likely to be changed, it is true, by the extension of price regulation to the intrastate market under the Natural Gas Policy Act (see page 14, *supra*). But the provisions of the NGPA may provide their own incentives. Producers may believe that gas from dedicated acreage, if withheld from delivery under existing contracts, may qualify for higher prices under one of the price cate-

[27] The Consumer Federation of America contended that certificated contracts set forth a specific, quantitative delivery obligation, measured by the producer's history of deliveries, that could be enforced by the Commission and the purchasers (A. 416-422).

gories of the NGPA.[28] It is difficult to predict precisely what economic incentives producers will have under the NGPA. But whatever they may be, and precisely because of the uncertainties ushered in by the new Act, confirmation of the Commission's ability to establish and enforce a delivery standard for dedicated gas is important. It will ensure that the Commission has power to enforce delivery obligations in any situation where this may prove to be necessary. The decision of the court of appeals, on the other hand, deprives the Commission of such authority in a sweeping and absolute manner.

The Commission's ability to enforce delivery standards is also important to other objectives of the Natural Gas Policy Act. For instance, the NGPA is expected to make available to interstate pipelines sub-

[28] Several provisions of the Natural Gas Policy Act reflect congressional awareness of possible incentives to withhold gas from interstate commitments in the hope of selling it under legislative classifications permitting higher prices. Thus, with respect to gas qualifying as "new natural gas" as defined in Section 102 of the Act, Congress has provided an exclusion for "withheld gas," *i.e.*, gas produced through an old well or gas for which suitable facilities for production and delivery to a pipeline were in existence on April 20, 1977. Section 102(C)(1)(c)(iii) of the NGPA. Although "new natural gas" previously dedicated to interstate commerce will be removed from the Commission's jurisdiction under Section 1(b) of the Natural Gas Act by Section 601(a)(1)(B) of the NGPA, "withheld gas" will remain subject to that jurisdiction. Similarly, the "behind-the-pipe" exclusion in Section 102 denies "new natural gas" treatment to production from reservoirs penetrated by old wells prior to April 20, 1977, from which gas or oil could have been produced in commercial quantities. Section 102(c)(1)(C)(ii).

stantial volumes of additional gas, but at higher prices than those prevailing under presently certified contracts. To mitigate the price increases, the structure of the Act is designed to allow interstate pipelines to continue to rely on presently certificated contracts during the next few years. See Sections 101 (b)(9), 104, 106(a), and 601(a)(1)(B). The assurance of this congressional purpose requires that existing certificate obligations be made effective by a meaningful delivery standard.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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NOVEMBER 1978

APPENDIX

Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b) provides:

> (b) Transactions to which provisions of chapter applicable
>
> The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, tot he sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or tot he local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

Section 7(b) of the Natural Gas Act, 15 U.S.C. 717f(b) provides:

> (b) Abandonment of facilities or services; approval of Commission
>
> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such faciilties, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public covnenience or necessity permit such abandonment.

Section 7(c) of the Natural Gas Act, 15 U.S.C. 717f(c) provides in pertinent part:

> (c) Certificate of public convenience and necessity
>
> No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: * * *

* * * * *

Section 7(e) of the Natural Gas Act, 15 U.S.C. 717f(e) provides:

> (e) Granting of certificate of public convenience and necessity
>
> Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, con-

> struction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

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IN THE

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OCTOBER TERM, 1978

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CONSUMER ENERGY COUNCIL OF AMERICA,
Petitioner,

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FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

BRIEF OF RESPONDENT PRODUCERS

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[List of Additional Respondent Producers continued on Inside Front Cover]

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BRIEF OF RESPONDENT PRODUCERS

I. INTRODUCTION

Shell Oil Company, *et al.*[1] (herein called "Producers") who were petitioners or intervenors in the case below, submit this Brief in opposition to the positions taken by the Federal Energy Regulatory Commission[2] (successor

---

1. A full list of the Producers joining herein is contained on the inside cover of this Brief.

2. Supported by Associated Gas Distributors ("AGD") *amicus curiae*.

to the Federal Power Commission, both of which are referred to herein as "Commission"), and Consumer Energy Council of America[3] (successor to Consumer Federation of America, herein called "CEC").

II. COUNTERSTATEMENT[4]

In this proceeding, the Commission and CEC are attempting to obtain this Court's approval for a massive expansion of Commission jurisdiction. The Commission and CEC seek to obliterate the distinction between the Commission's jurisdiction over "sales in interstate commerce for resale" of natural gas and its lack of jurisdiction over "production activities" which this Court so carefully crafted in a long series of cases commencing with *Colorado Interstate Gas Co. v. F.P.C.*, 325 U.S. 581 (1945), and extending through *F.P.C. v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949); *Interstate Natural Gas Co. v. F.P.C.*, 331 U.S. 682 (1947); *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), to *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965). Despite the clear language of this Court, which we will discuss in the Argument section, *infra*, that Section 1(b) of the Natural Gas Act ("Act") was to be afforded its clear meaning, Petitioners seek to read the exclusion of jurisdiction over "production and gathering" as being without substance.

---

3. Supported by American Public Gas Association ("APGA") and Action Alliance of Senior Citizens of Greater Philadelphia ("Senior Citizens") *amicus curiae*.

4. At pages 3-10 of its Brief, CEC gives an inaccurate and incomplete explanation of the reasons for the natural gas shortage. The Counterstatement herein gives the full history of the development of the shortage and its causes.

Although the Commission now regards the question as a pure legal issue, having finally abandoned the rationale which led to the institution of this proceeding in the first place, CEC and its supporting *amici* continue to assert that this expansion of Commission jurisdiction is necessary to prevent the producers from refusing to deliver the reserves which they have discovered (CEC Br. pp. 19-21) (APGA Br. p. 6).

CEC's (as well as APGA's and Senior Citizens') position rests on a simplistic and fundamental misunderstanding of the engineering principles underlying gas production, the economic causes of the gas shortage, and the contractual and legal structure under which the industry operates. By blandly assuming "facts" which do not exist, these parties create a grossly false picture of the role of producers and pipelines in finding, producing, and transporting gas to the consumer.

The basic assumption which underlies the entire argument of CEC dealing with the so-called "service obligation" of the producer, is the implication that a gas reservoir will continue to produce forever, either at a "stable" rate (p. 34) or at least at a predictable rate of decline (p. 45). Unfortunately, gas reservoirs are not the simple, predictable creatures that CEC would like them to be. Gas reservoirs contain only a finite quantity of gas, and the amount of gas remaining in the reservoir, and the ability of the reservoir to deliver the gas, begins to decline with the first day of production. The rate of decline is dependent on the interaction of gas and water pressures in microscopic spaces in the porous rock of the producing formation, thousands of feet beneath the surface. The only information which the producer, or

anyone, can have of these forces is gained by observing the results of their actions through a few well bores, some 6 to 10 inches in diameter, spaced as much as a mile apart. It is therefore not surprising that reserves estimates are imprecise, and deliverability projections often very wrong, because of some action occurring within the reservoir which is unknown or unexplainable. Reductions in the ability of gas to move through the reservoir rock to the well bore may be alleviated by drilling additional wells, or reworking existing wells, or by installing compression; but production from the reservoir may continue to decline despite any or all of these actions. In most cases the question whether additional capital expenditures by a producer in a producing reservoir will result in additional reserves, or enhanced delivery from existing reserves, cannot be accurately answered without making the capital expenditure. If the well is drilled and no additional gas results, the producer has lost his capital with no resulting benefit.

In Appendix A to this Brief,[5] we have attached a diagram showing the depletion curve of a typical gas field. In the early years of the field, the fact that the deliverability of the field is constantly declining is obscured by another factor. When a pipeline constructs facilities to connect a specific field to its pipeline system, it does not size the facilities to receive the maximum amount the field can produce in its most prolific period (150 MMcf per day in our diagram). This would be an imprudent investment, as the pipeline knows that the field cannot continue to produce at that rate for very

5. A similar diagram was utilized by Producers' counsel in oral argument to the Commission, and is discussed at Appendix pages 396-98.

long. Therefore, the pipeline is constructed to take a maximum which is less than the initial productive capacity of the field (100 MMcf per day in the diagram), and takes that quantity all through the "flush" production days of the field (years 1 through 6 in our diagram). There comes a point in time in every field when the reservoir will no longer produce as much gas as the pipeline is capable of taking. From this time on, the production from the field (or to use CEC's terms, the service the field is capable of rendering) is based, not on the capacity of the pipeline, but on the ability of the reservoir to produce.

The supply shortage, lamented by CEC and its *amici* allies,[6] is a result of depletion of gas reservoirs discovered many years ago, on a national scale. Until the early 1960s, the depletion of older, previously discovered gas fields was offset by the continuing discovery of new fields. Following *Atlantic Refining Company v. Public Service Commission of New York (CATCO)*, 360 U.S. 378 (1959), the Commission began a series of proceedings designed to "hold the line" on prices received by producers until the Commission had established just and reasonable rates, see *United Gas Improvement Co. v. Callery Properties, Inc.*, 382 U.S. 223 (1965) and *F.P.C. v. Sunray DX Oil Co.*, 391 U.S. 9 (1968). Although proceedings began in 1961 and 1963, just and

6. The concern of APGA over supply is particularly ironic. In all of the area rate proceedings before the Commission in the 1960s and early 1970s, this same group took the position that the Commission need not consider supply at all in establishing ceiling prices, and that the producers' claims of an impending supply shortage if prices were not increased was a "hoax"! See *Placid Oil Co. v. F.P.C.*, 483 F.2d 880, 894, n. 13 (1973), *affirmed Mobil Oil Corp. v. F.P.C.*, 417 U.S. 283 (1974).

reasonable rates were not established in the largest producing areas, the Texas Gulf Coast and Southern Louisiana Areas, until 1971. The Commission had been so successful in "holding the line" on prices that the just and reasonable rates established by those decisions, utilizing outdated cost averages as a basis, barely exceeded the contract prices prevailing some ten years earlier.[7]

Throughout the decade of the 1960s, while the price for the product which they sold remained frozen, the producers faced steadily rising costs, occasioned by two factors: (i) the general inflationary trend of the economy, which raised the cost of labor and material for gas producers as well as everyone else; and (ii) a special inflationary factor applicable to the oil and gas production business. This factor has been described by economists as the "declining resource base". It can be explained in the following manner: The total number of gas fields in the United States is a finite number. Whatever that number is, it will not increase within any time span material to anyone living today. With each gas field which is found, one less remains to be found in the future. Obviously, the shallowest, cheapest, easier-to-find fields are found first. This leaves the fields remaining to be found progressively to be those which are the deeper, more costly, and less accessible.

Responding to these real economics (and not to the artificial calculations of return on historic costs made

7. In the sales involved in the *CATCO case*, *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378 (1959), the contracts provided for an initial price of 22.4 cents per Mcf, 360 U.S. 378, 383. In March 1972, thirteen years later the average price paid domestic producers by interstate pipelines' averages 20.29 cents per Mcf, see Press Release No. 19278, issued by the Commission on June 1, 1973.

by witnesses in Commission proceedings), the exploration for gas in the United States declined. As a result, the new gas reserves discovered amounted to approximately half of the gas being produced and consumed for a nine-year period.[8]

Again in response to immutable laws of supply and demand, as the older reservoirs continue to decline in their ability to deliver gas and new reservoirs were not being discovered rapidly enough to replace them, shortages began to occur. The unregulated intrastate market, which has previously been able to obtain all the supplies it needed by merely matching the price fixed by the Commission for the interstate market, began to react, as all free markets do, by increasing the prices it paid for the commodity it needed. This increase in prices in turn led to a rejuvenation of gas exploration, but specifically directed toward the free intrastate market, and away from the controlled interstate market. Recognizing this trend, the Commission acted in the National

8. See table taken from Staff Report No. 2 setting out production and reserve figures and R/P ratios 1966-1975, cited by the Fifth Circuit in *Placid Oil Co. v. F.P.C.*, 483 F.2d 880, 895 (1973), reproduced as Appendix B.

More recent figures appear in Appendices C and D, also attached. Appendix C is Chart 1, reproduced from page 111 of the Annual Report of the American Gas Association, Vol. 32, June 1978, entitled "Reserves of Crude Oil, Natural Gas Liquids, and Natural Gas in the United States and Canada as of December 31, 1977" shows the trend of reserves additions and production, with the resultant impact on proved reserves (the anomaly in 1970 was the addition of Alaskan Prudhoe Bay reserves). Appendix D, attached hereto, is Table 5 from a Report by the Commission's Bureau of Natural Gas issued January 1977, page 17 showing the decline in reserves dedicated to interstate commerce as of December 31, 1963 compared with new supply added, with a resultant decline in year end reserves of interstate pipeline companies from 188 trillion cubic feet to 106 trillion cubic feet.

Rate Cases[9] to increase interstate prices, but always "too little and too late" to allow exploration to find new reservoirs rapidly enough to offset those older reservoirs which were steadily declining (A. 451).

CEC and APGA seized on the typical provision of producer contracts which required the producer to sell and deliver, and the pipeline purchaser to take or pay for, as minimum daily contract quantity of gas ("DCQ").[10] The purpose of this provision was to require the *pipeline* to take at least this amount of gas each day, or pay the producer for it if not taken. Throughout much of the 1960s, many pipelines were in so-called "take-or-pay" positions, to the point that consumer advocates demanded that that issue of a pipeline's need for the gas be resolved before a certificate was issued to a producer. The Commission instead chose to deal with this issue in *pipeline* certificate proceedings, and was upheld in so doing by this Court, see *F.P.C. v. Sunray DX Oil Company*, 391 U.S. 9, 47 (1968). This provision was important only during conditions of oversupply, either on a national or a field basis (see years 1 through 6, diagram on Appendix A). All of these contracts contained other provisions, which provided, although the wording varied somewhat,

9. *National Rate Case For New Gas*, Docket No. R-389B, Opinion No. 699, 51 F.P.C. 2212; Opinion No. 699-H, 52 F.P.C. 1604; *affirmed Shell Oil Company v. F.P.C.*, 520 F.2d 1061, *rehearing denied*, 525 F.2d 1261 (5th Cir. 1975), *cert. denied sub nom. California Co. v. F.P.C.*, 426 U.S. 941 (1976); *National Rate Case For Flowing Gas*, Opinion No. 749, ____F.P.C.____, *affirmed Tenneco Oil Co. v. F.E.R.C.*, 571 F.2d 834 (5th Cir. 1978); *Second National Rate Case For New Gas, American Public Gas Association v. F.P.C.*, 567 F.2d 1016 (D.C. Cir. 1977), *cert. denied*, ____U.S. ____, 55 L.Ed.2d 499 (1978)

10. Typical contract provisions appear in the record at Appendix 36-39, 83-89, 101.

that the DCQ would be reduced when the fields committed to the contract were no longer capable of producing the quantities set out in the contract. The contracts further preserved, in one form or another, the right of the producer to decide how the field would be developed and produced, so that the pipeline could not "second guess" the management decisions involved. Typical contract provisions were introduced into the record below.[11]

This was the situation in the fall of 1975, when the Commission was hailed before the Subcommittee of Oversight and Investigation of the House Interstate Commerce Committee to answer charges by consumer advocates that it was not requiring producers to live up to their contract and certificate obligations.[12] The Commission responded with Order No. 539 issued on October 14, 1975, without notice, hearing or opportunity to comment, which announced the Commission's intention to enforce all "delivery and supply obligations" purportedly contained in producer contracts and producer and pipeline certificates (A. 2-14). Producers filed an Application for Rehearing (A. 16-26) which stated that the Producers *were* complying with all of their contract and certificate obligations.[13] This pleading further pointed out that the rate of decline in deliveries was determined by the reservoir mechanics of the field, not the parties to the contract, and the contracts typically reflected this basic fact, providing that the seller would never be required to deliver more than his wells would produce or amounts

11. Appendix 37, 78, 88-89, 102.

12. See decision of the Court of Appeals, A. 3a, n. 1.

13. The Commission now appears to agree with the statement of the producer's obligations under a typical gas sales contract, see Brief, pp. 5, 6, n. 2.

in excess of that permitted by the appropriate State regulatory body (A. 37, 78, 88-89, 102).[14]

This pleading was followed by a Petition for Rehearing by Tenneco Oil Company, *et al.* (A. 144-156), and by a Motion for Oral Argument by Shell Oil Company, *et al.*, (A. 160-198), which pointed out in detail that reservoirs and delivery conditions varied widely, and that neither the parties to a gas sales contract nor the Commission in issuing the certificate could make the reservoir continue to produce when all the gas was gone, or in many cases, even materially affect the natural rate of decline caused by depletion of the reserves. Following Order No. 539, the Commission began to attach conditions to producer certificates requiring the producer to comply with the "delivery obligations" (A. 229) of his contract or certificate, without any indication of what the Commission believed those obligations to be (A. 204-235). By Order issued February 12, 1976 (A. 236-256), the Commission set a number of these certificate applications down for hearing, requiring the producers to submit reserve and deliverability estimates on the reserves being committed.[15] On March 26, 1976 (A. 263-281), the Commission issued Order No. 539-A which added to the confusion. On the one hand, the Commis-

14. CEC appears to question the intent of the typical gas contract (p. 14) on the basis of whether those contracts in the record contain a "sole discretion" clause. What CEC does not understand is that this contract provision took many forms, including a reduction in the DCQ, whenever the seller failed to deliver that quantity, see *e.g.*, A. 102.

15. Commissioner Watt filed concurring opinions objecting to the Order 539 requirements (A. 234, 257). This hearing was later cancelled in favor of the rule-making proceeding instituted by Order No. 539-A (A. 263-81).

sion assured the producers that "it did not intend to imply that a take-or-pay provision in a contract necessarily constituted the delivery obligation" (A. 269), and that "Order 539 does not impose a specific warranty obligation if none is provided for in the contract.[16] (A. 270). On the other hand, the Commission reaffirmed its intention to insert a new condition in all future producer certificates providing for the determination of a "certificated minimum daily delivery obligation of the seller" calculated on the basis of the producer's contract "unless changed by the certificate authorization" (A. 278). The Commission propounded a series of questions (A. 276) and requested submission of Comments and oral argument.

After receiving Comments and hearing oral argument, in which the Commission was repeatedly told by pipelines (A. 304-317) as well as producers that it was failing to recognize that estimating reserves before they are produced is an art, not a science, that gas is a wasting asset, that production levels continuously decline, and that neither the contract nor the certificate provide any guarantees as to the total amount of reserves or the

16. *Gulf Oil Corporation v. F.P.C.*, 563 F.2d 588 (3rd Cir. 1977) cited by CEC (p. 10) as the "only . . . meaningful enforcement action to counter flagging deliveries" is clearly distinguishable on the facts from the case at bar. Gulf had agreed to supply a certain daily quantity of gas, regardless of source, for a certain time period, and had been so certificated by the Commission. In oral argument to the Commission below, counsel for Texas Eastern Gas Pipeline Company, the purchaser in the Gulf contract stated: "You can count these warranty contracts on the fingers of your left hand." (A. 460) The distinction between a "warranty contract" and a conventional contract was discussed in *Shell Oil Company v. F.P.C.*, 531 F.2d 1324, 1327, n. 6 (5th Cir. 1976).

rate of delivery (A. 307-308),[17] the Commission issued Order No. 539-B on July 30, 1976. In that Order the Commission withdrew the certificate conditions imposed in Order Nos. 539 and 539-A relating to a "certificated minimum daily delivery obligation" and imposed instead the "standard of the prudent operator to develop and maintain deliverability from reserves dedicated hereunder" (Comm. Br. p. 3) on all certificates issued after October 14, 1975. The Commission further found that this obligation was "implicit" in all prior certificates which it had issued, even though these certificates contained no language, or any hint that the Commission might later assert jurisdiction in this area.

The "prudent operator" standard imposed by the Commission in Order No. 539-B was the same standard described in State oil and gas law[18] as controlling actions between the lessor and lessee. (Br. p. 32). Under that standard, the lessee is required to conduct only those operations which an ordinary prudent operator would carry out "having due regard for the rights of both the lessor and lessee"[19] and was not required to perform

17. Mr. McGrath, General Counsel for the Interstate Natural Gas Association of America (consisting of all the major pipelines in the United States) stated on oral argument: "Nowhere does the Commission certificate or is there any basis for it to certificate a minimum daily deliver obligation. It cannot be done, we submit, because of the varied nature of the resources with which we are dealing, *i.e.*, natural gas. Every day a well is produced that gas is gone, the reservoir is depleted to that extent." (A. 446) . . . "You are trying to impute a delivery obligation which is just not there." (A. 447)

18. 5 H. Williams and C. Meyers, *Oil and Gas Law*, §§ 804, 806-808; 2 Summers, *Law of Oil and Gas*, 559-644; Merrill, *Covenants Implied in Oil and Gas Leases*, §§ 7, 220.

19. 5 H. Williams and C. Meyers, *Oil and Gas Law* § 806.3.

any operations which could not reasonably be expected to return his costs and a reasonable profit.[20] If the lessee had violated this standard, the penalty was usually forfeiture of the lease.[21]

The Commission receded from its position that producers were violating their contracts, and concluded that there was no evidence of withholding gas from the market. Nevertheless, the Commission asserted the right to regulate production operations of a gas producer selling in interstate commerce, under its authority to prevent the abandonment of service under Section 7 of the Act.

The Court of Appeals rejected the Commission's position, carefully reviewing this Court's decisions on the scope of the "production and gathering" exclusion. The Court of Appeals found that in administering the proposed certificate condition, the Commission intended to dictate to the producer whether new wells should be drilled, and that this clearly involved the Commission in the production activity, even though done in the guise of "maintaining service". The Court of Appeals held that the asserted jurisdiction of the Commission would "all but eliminate the 'production and gathering' exclusion and allow the FERC to encroach on areas reserved to the states" (A. 9a). Order No. 539-B was vacated and remanded as exceeding the Commission's jurisdiction under the Natural Gas Act.

20. Id.

21. Id., § 808.

III. SUMMARY OF ARGUMENT

The extension of the Commission's jurisdiction over production operations, including the asserted power to require drilling of new wells and other capital expenditures by producers, violates Section 1(b) of the Natural Gas Act, which excludes "production and gathering" from the jurisdictional reach of the Commission. The dividing line between "production and gathering" (non-jurisdictional) and "sales for resale" (jurisdictional) which was carefully drawn in *Phillips* and the other decisions of this Court cited in the Argument section, *infra,* has never before been breached. Although this Court's decisions in *Sunray Mid-Continent Oil Co. v. F.P.C.,*[22] and *California v. Southland Royalty Co.,*[23] preclude abandonment of certificated service due to a change in the contractual position of the producer, assuming that gas is available for sale from committed reserves, they do not authorize the Commission to inject itself into the production function and direct the producer as to how, when and where his capital is to be invested to produce the gas reservoir most efficiently. Such jurisdiction would place the Commission squarely in conflict with the jurisdiction of the State Conservation Agencies approved by this Court in *Champlin Refining Co. v. Corporation Commission.*[24] We do not argue that Congress could not preempt State jurisdiction — but in passing the

22. 364 U.S. 137 (1960).

23. ____U.S.____, 98 S.Ct. 1955, 56 L.Ed.2d 505 (1978).

24. 286 U.S. 210 (1931).

Natural Gas Act this Court has repeatedly held this was not its intention, see *e.g., F.P.C. v. Panhandle Eastern Pipe Line Company.*[25]

The Court is confronted in this case with no regulatory gap. The decision of the Court of Appeals creates no hiatus between those areas controlled by the Commission and those areas which the States have the power to control. Rather, the Commission claims that despite the *absence* of a regulatory hiatus caused by constitutional prescriptions against exercise of state power, the Commission nevertheless needs the power to control production to effectuate its statutory responsibilities under the Natural Gas Act. In essence, the Commission's argument is not that there is a regulatory gap between past exercise of power by the Commission and that exercised by the States, but rather that the bifurcated system designed by Congress is not adequate to allow the Commission to fulfill its perceived mandate (Br. p. 23). However, the bifurcated structure is the system designed and intended by Congress. Thus, perceived shortcomings in that system are a legislative matter which can only be remedied by Congress.

The reason behind the assertion of the Commission's jurisdiction is now conceded by the Commission (but not CEC) to be non-existent. Far from generating additional gas supplies as CEC and APGA imply, the expansion of Commission jurisdiction will lead to hundreds, if not thousands, of proceedings as the Commission delves into the difficult questions of why pro-

25. 337 U.S. 498 (1949); see also cases cited in Argument section, *infra.*

duction has declined from a reservoir and what, if anything, can be done to increase it. The uncertainty created by this additional regulation will undoubtedly reduce exploration for gas generally, with a consequent *adverse* impact on gas supply.

IV. ARGUMENT

A. Prior Cases Of This Court Establish A Clear Distinction Between "Production Activities" And "Sales For Resale".

The Commission and CEC attempt to read this Court's decisions in *Phillips, supra,* and *United Gas Improvement Co. v. Continental Oil Co., supra,* as effectively eliminating the "production and gathering" exclusion contained in Section 1(b) of the Natural Gas Act.[26] This construction does violence to both the spirit and the language of those decisions, and places them in conflict with a number of earlier (and later) decisions of this Court. What this Court actually said in *Phillips* was this:

> " . . . Phillips['] . . . sales in interstate commerce of natural gas for resale are subject to the jurisdiction of and regulation by the Federal Power Commission." (347 U.S. at 677)
>
> * * *
>
> "We are of the opinion . . . that production and gathering, in the sense that those terms are used in § 1(b), end before the sales by Phillips occur.

26. See Court of Appeals' Opinion below, Appendix B, p. 9a.

> "In Federal Power Com. v. Panhandle Eastern Pipe Line Co., 337 U.S. 498, 505, 93 L.Ed. 1499, 1505, 69 S. Ct. 1251, we observed that the 'natural and clear meaning' of the phrase 'production or gathering of natural gas' is that it encompasses 'the producing properties and gathering facilities of a natural-gas company.' Similarly, in Colorado Interstate Gas Co . v. Federal Power Com. 324 U.S. 581, 598, 89 L.Ed. 1206, 1220, 65 S. Ct. 829, we stated that '[t]ransportation and sale do not include production or gathering,' and indicated that the "production or gathering" exemption applies to the physical activities, facilities, and properties used in the production and gathering of natural gas. *Id.*, 324 U.S. at 602, 603. See also Federal Power Com. v. Hope Natural Gas Co., 320 U.S. 591, 612-615, 88 L.Ed. 333, 350-352, 64 S.Ct. 281; Peoples Natural Gas Co. v. Federal Power Com., 75 App. D.C. 235, 127 F.2d 153; cf. United States v. Public Utilities Com., 345 U.S. 295, 307-311, 97 L.Ed. 1020, 1033-1035, 73 S.Ct. 706." (347 U.S. at 678)

In *Phillips,* the producer made the argument that the sale of the natural gas was "incidental" to production, and therefore excluded from Commission jurisdiction, and the Commission so found (10 F.P.C. 246, 278; 347 U.S. 672, 677). This Court disagreed finding that "production and gathering, in the sense that those terms are used in § 1(b), end before the sales by Phillips occur", 347 U.S. 672, 678. In the case at bar, the Commission and CEC arguments are a mirror image of those made by the producer in *Phillips.* The Commission's premise is that "production" is incidental to the "sale", and therefore jurisdictional. The same reasoning which led this Court to reject the implication that the sale is incidental to the production, leads to rejection of this thesis that

production is incidental to the sale and therefore jurisdictional. As we read *Phillips*, the Court was saying that "production and gathering" and "sale for resale" are two distinct functions, although both may be performed by the same person. The "production and gathering" function is subject to State regulation; the "sale for resale" function is subject to Commission jurisdiction.[27]

Nor did this Court's decision in *United Gas Improvement Co. v. Continental Oil Co.* (Rayne Field), *supra* alter the clear distinction set out in *Phillips* between the Commission's jurisdiction over "sales for resale" (even though in that case the sale occurred *before*, instead of *after* production) and its lack of jurisdiction over the "physical activities, facilities, and properties used in the production and gathering of natural gas" *Phillips*, 347 U.S. at 678. This Court in *Rayne Field* said:

> "We conclude that even though a sale of natural gas in interstate commerce occurs before production or gathering is ended, it is nonetheless subject to regulation. In the context of such a sale, as distinguished from the situation in FPC v. Panhandle Eastern Pipe Line Co., 337 U.S. 498, 93 L.ed. 1499, 69 S.Ct. 1251, to be discussed hereafter, the 'production or gathering' exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction. This accommodation of the two relevant clauses of § 1(b) gives content to the national objectives of the Natural Gas Act as expounded in Phillips, and to the Commission's jurisdiction to accomplish them,

27. CEC's word game, which "focuses on the services rendered" (Br. pp. 25, 26) does not change the basic structure of either the industry or the law.

> while in no way interfering with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate state concerns." (381 U.S. 392, 403-404)

In the light of this Court's clear language on the distinction between the "physical processes of production and gathering" on the one hand, and the "sales for resale" on the other, the general language quoted by the Commission (pp. 24, 27) is not controlling.

To construe *Phillips* and *Rayne Field* as abolishing the "production and gathering" exclusion of Section 1(b) would place these decisions in square conflict with other decisions of this Court. In *Panhandle Eastern Pipe Line Company v. Public Service Commission*, 332 U.S. 507 (1947), this Court stated:

> "Three things and three only Congress drew within its own regulatory power, delegated by the Act to its agent, the Federal Power Commission. These were: (1) the transportation of natural gas in interstate commerce; (2) its sale in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale." (332 U.S. 507, 516)

Far from being overruled by *Phillips*, this language was reiterated by the Court in *F.P.C. v. Louisiana Power & Light Company*, 406 U.S. 621, 636 (1972).

The Natural Gas Act did not envisage federal regulation of the entire natural gas field to the limit of constitutional power, *F.P.C. v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 502 (1949), but was intended to encompass only that area which the States were precluded from regulating, *Interstate Natural Gas Company v.*

F.P.C., 331 U.S. 682, 689-93 (1947); *Public Utilities Commission v. Attleboro Steam & Electric Company*, 273 U.S. 83 (1927). In the *Interstate* case, this Court said:

> "Clearly, among the powers thus reserved to the States is the power to regulate the physical production and gathering of natural gas in the interests of conservation or of any other consideration of legitimate local concern. It was the intention of Congress to give the States full freedom in these matters." (331 U.S. 682, 690)

In *Colorado Interstate Gas Co. v. F.P.C.*, 324 U.S. 581 (1945), after finding that the Commission could include production properties in the rate base of an interstate pipeline company, this Court stated the following:

> "That does not mean that the part of § 1(b) which provides that the Act shall not apply to 'to the production or gathering of natural gas' is given no meaning. Certainly that provision precludes the Commission from any control over the activity of producing or gathering natural gas. For example, it makes plain that the Commission has no control over the drilling and spacing of wells and the like." (324 U.S. 581, at 602-03)

The previous year in *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), this Court also noted:

> ". . . the Act does not intrude on the domain traditionally reserved for control by state commissions; and the Federal Power Commission was given no authority over 'the production or gathering of natural gas.' § 1(b). In addition, Congress recognized the legitimate interests of the States in the conservation of natural gas." (320 U.S. 591, at 612-13)

What does "production and gathering" consist of? In *Northern Natural Gas Co. v. State Corporation Commission*, 372 U.S. 84 (1963), this Court defined them as "the physical acts of drawing the gas from earth and preparing it for the first stages of distribution" 372 U.S. 84, 89.[28]

The "physical act of drawing the gas from the earth" is the very thing which was being regulated by the States at the time the Natural Gas Act was passed, *Champlin Refining Co. v. Corporation Commission, supra*, and was therefore excluded from Commission jurisdiction under the *Panhandle* line of cases, above cited.

CEC proposes to avoid this long line of decisions of this Court by the simple expedient of talking about "service" instead of "production" (p. 25, 26). As AGD recognizes, "the quantity of gas sold is necessarily determined by the quantity of gas produced" (Br. p. 5). Thus, the focus must remain on whether the Commission has jurisdiction over production.

This Court's decisions in *Sunray Mid-Continent Oil Company v. F.P.C., supra* and *California v. Southland Royalty Company, supra* do not require a contrary result.

In *Sunray*, this Court sustained the Commission's power to issue a certificate of public convenience and

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28. See also *Phillips, supra*, 347 U.S. 672, 680, 681; *Continental Oil Co. v. F.P.C.*, 266 F.2d 208 (5th Cir. 1959); *J.M. Huber Corp. v. F.P.C.*, 236 F.2d 550 (3rd Cir. 1956); *F.P.C. v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 518 (1949); *Continental Casualty Co. v. Associated Pipe & Supply Co.*, 447 F.2d 1041 (5th Cir. 1971).

necessity extending beyond the term of the producer's contract, and to prevent the producer from abandoning the "service" when his contract expired. But the Court did not grant the Commission jurisdiction to require producers to "drill additional wells and take affirmative measures to maintain pressure in the reservoir" as the Commission now claims the authority to do (Br. p. 33). The Court held only that, having dedicated the production from the fields included under his contract to interstate commerce and having received a certificate for such a sale, the producer could not cease the sale and sell the gas instead on the intrastate market. It is quite a different thing to say "if the field produces gas you must sell it to this buyer" as opposed to "you must make this field continue to produce until the Commission lets you stop, regardless of what it costs you".

In fact, this Court in *Sunray* specifically refused to consider whether the Commission's order requiring the producer to continue deliveries "offended" the "production and gathering" exclusion of the Act, as this issue was not raised before the Commission. The Court said "we intimate no view as to its merits", 364 U.S. 137, 157.

Likewise *California v. Southland Royalty Company, supra* is distinguishable on the facts from the case at bar. In *Southland*, the Court held that the obligation not to abandon service was not limited by private contracts, whether between the producer and the pipeline as in *Sunray*, or between the producer and his lessor in *Southland*, 56 L.Ed.2d 505, 511. In the present case, the limitation on service is imposed, not by private contract, but by the natural reservoir forces. The Commission cannot require a depleted gas field to deliver gas by refusing to grant abandonment authority; neither can it require the producer to invest additional capital in what may be a useless effort to continue service from a depleted field.

The clearest discussion of the interrelationship between the "production and gathering" exclusion and the abandonment provisions of Section 7 appears in *F.P.C. v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 509-512. There the Court was discussing an argument made by the Commission, quite similar to their argument here, that its power to grant or deny abandonment under Section 7 gave it the power to refuse to permit Panhandle to assign gas leases which were connected to its system to a subsidiary company, because this would impair its ability to "maintain adequate service". The Court held that the powers under Section 7 extended only to "facilities subject to the jurisdiction of the Commission", and since leases were "production facilities" not jurisdictional facilities, the Commission had no power to prevent their abandonment, even by a pipeline company. The Court quoted at length from the Congressional debate on the Natural Gas Act in reaching its conclusion, 337 U.S. 498, 509-512.

The language of the Act having been designed, at least primarily, for the regulation of pipeline companies, speaks in terms of abandonment of "service".[29] Yet the obligations of pipeline and producer to "continue service" are quite different. A pipeline's "facilities" are clearly

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29. In *Permian Basin Area Rate Cases*, 390 U.S. 747, 756 (1968), the Court said: "The Commission has since labored with obvious difficulty to regulate a diverse and growing industry under the terms of an ill-suited statute."

subject to Commission jurisdiction; the majority of a producer's facilities, because they are production facilities, clearly are not. A pipeline can "continue service" indefinitely with its existing system, as long as the fields which supply the system will still produce gas, without making any additional capital investments. In fact, the Courts have held the Commission has no authority to require a pipeline to enlarge its facilities, see *Panhandle Eastern Pipe Line Co. v. F.P.C.*, 204 F.2d 675 (3rd Cir. 1953) and *Central West Utility Co. v. F.P.C.*, 247 F.2d 306 (3rd Cir. 1957). To say that a producer, whose facilities are not jurisdictional, must drill wells and install additional production equipment to maintain the deliverability of his wells, even if there were no doubt about the result, in response to a Commission order, expands the Commission's jurisdiction over producers beyond that which it has over pipelines, which it was first intended to regulate.

Contrary to the allegations of CEC and APGA, the Commission's regulations dealing with producer applications contain no provisions regarding reserve or deliverability estimates, at least prior to the Orders below, see 18 C.F.R. §§ 157.5-157.15. A pipeline is connected to many fields, and has many contracts which it uses to satisfy its customers (A. 446-447). The pipeline, *not the producer*, makes estimates of deliverability of its system, which vary from time to time, and depend on the purchase of gas from new fields to replace that produced from older depleting fields.[30] It is the inability

30. The Regulations quoted at pages 9-11 of APGA's Brief apply *only* to *pipeline* certificate applications, *not* to producer applications.

of the pipelines to purchase sufficient replacement gas that has led to the shortage (A. 451).

The basic fallacy in the CEC-APGA position is that reserves and deliverability figures are only estimates, not guarantees. If these estimates are wrong, the power of both the producer and the Commission to make the reservoirs produce as predicted is extremely limited.[31]

B. There Is No Policy Reason Why The Commission Must Have The Jurisdiction It Claims.

The original basis for Order No. 539 was the charge that producers were withholding gas from the pipeline purchasers in order to force the Commission to increase the price ceilings, and to persuade Congress to deregulate natural gas.[32] Similar charges by industry critics (including APGA) resulted in extensive investigations and audits by the Commission during the hearings of the *Southern Louisiana Area Rate Case*, and a finding by the Commission that the reserves figures placed in the record by the producers were "reasonably reliable" 46 F.P.C. 86, 116.[33] The Commission's conclusion was affirmed by the

31. Insisting that a producer cannot abandon service from a depleted reservoir until it was authorized to do so, is similar to Xerxes of Persia scourging the sea with whips because it would not obey his bidding.

32. CEC (p. 34), APGA (pp. 2-6), and Senior Citizens (pp. 10-12) still cling to these charges, despite the fact that they have been repeatedly shown to be without substance.

33. Similar investigations by the Federal Trade Commission (see *Federal Trade Commission v. Texaco*, 555 F.2d 862 (D.C. Cir. 1977), *cert. denied*, 97 S.Ct. 2939 and the Subcommittee on Oversight and Investigation of the House Interstate Commerce Committee resulted in no evidence of withholding, see Staff Memorandum from John Galloway, Special Assistant, dated May 4, 1976, Congressional Record, dated December 15, 1977, H. 13005-6, E. 7427.

Fifth Circuit in *Placid Oil Co. v. F.P.C.*, 483 F.2d 880, 894-896, which rejected APGA's reference to "supplies" of gas as a "misleading oversimplification" (483 F.2d 880, 894, n. 13). APGA and CEC continue to fail to draw vital distinctions between *undiscovered gas* (which may or may not be explored for, and if explored for, may or may not be found) and *discovered* gas, which must be produced expeditiously, because: (i) other lessees on adjoining leases in the same reservoir will deplete the reservoir from their wells; (ii) the lessor will insist on speedy and maximum production to receive his royalty and prevent waste and protect correlative rights. Significantly, the Commission now clearly concedes, that:

> "Order No. 539-B was based not on a finding that producers had been withholding deliveries of dedicated gas, but on the Commission's interpretation of the Act." (Br. p. 34)

The Court of Appeals found:

> "The impetus behind the FERC's actions was the charge made before various subcommittees of Congress that natural gas producers were avoiding the delivery obligations in their contracts of sale in order to realize greater profits. It was claimed that the producers were diverting natural gas from interstate to intrastate sales or withholding it in hope of future deregulation of the industry. No support for this charge appears in the record before us and the FERC stated in oral argument that its investigation has uncovered no evidence that the natural gas producers have been withholding supplies." (A. 3a)

Nevertheless, CEC and APGA continue to insist that the Commission must have authority to regulate the

"obligation" of the producer to continue "service" because otherwise the producer may "divert" (CEC p. 23) or "withhold" (APGA p. 6) gas in favor of unregulated categories, which they allege will be possible under the Natural Gas Policy Act of 1978 ("NGPA"). This allegation is absolutely contrary to the plain intent and clear language of the NGPA. Section 104 of the NGPA establishes the price for natural gas produced from old wells committed or dedicated to interstate commerce on November 8, 1978 as the just and reasonable rate established by the Commission. This gas is *never deregulated,* but remains subject to Commission jurisdiction for the life of the reserves (Section 601). While certain categories of "new wells" (drilled after February 19, 1977) are deregulated, *only* those new wells which are drilled to new reservoirs or to a different spacing or proration unit than existing wells are entitled to any different price treatment. Thus, the alleged "incentive" for producers to withhold gas from existing wells hoping for better price treatment no longer exists, if it ever did.[34] Congress has determined in the NGPA to eliminate

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34. APGA's statement (Br. p. 6) that "producers can refuse to deliver gas from such committed old wells and shift to deliver gas from new wells at higher prices" shows a lack of understanding of the mechanics of gas production and the NGPA. In order to receive the higher prices authorized by the NGPA, new wells must produce from reservoirs or spacing units (which are defined as the area which a well will drain) which could not be produced by existing wells. Thus, the two type wells produce from two distinct and separate sources, and it is a physical impossibility to "shift" production from one to the other. The exclusion in Section 102(c)(1)(c)(ii) and (iii) providing that "behind-the-pipe" gas and "withheld" gas will not qualify for the new gas ceiling rate, but will be held to the existing rates for old wells (Comm. Br. p. 37, n. 28) and designed specifically to *prevent* producers from receiving the new higher prices for previously discovered gas.

the Commission's jurisdiction under the Natural Gas Act, as to future wells.

C. The Asserted Jurisdiction Of The Commission Will Conflict With Existing Regulation of Production By State Agencies.

The cases cited in Section A, *supra,* show clearly that Congress excluded production and gathering from the Commission's jurisdiction because these activities were regulated by State Conservation Agencies. Yet CEC contends that the regulatory system set up by Congress does not adequately protect the consumer, because the State agency is primarily concerned with prevention of waste, and thereby sets maximum, not minimum, rates of production (Br. p. 41). Aside from the real issue whether the consumers' interests are better served by rapid depletion of existing reservoirs as opposed to producing them over a longer period,[35] the probability of conflict between State and Commission regulation is apparent. What if the State agency fixed the maximum rate of production from a field at 100 MMcf per day and the Commission fixed the minimum rate at 200 MMcf per day? How is the producer to proceed? The application of the standard cannot be blindly deferred for future consideration (Br. pp. 48, 57). Consideration of the many conflicts which would arise between the two jurisdictions attempting to regulate the same function[36] was a basic

35. At Appendix 457-58, counsel for the pipelines argued to the Commission that rapid depletion of fields would channel gas into undesirable uses and promote waste.

36. Examples of possible conflict are many. Suppose the Commission required the producers to drill an additional well at a point which violated the State's spacing orders. Would the Commission's order overrule the State law that a well cannot be drilled without a permit? State proration orders may restrict production below limits demanded by the Commission. The Commission could require compression to be installed in a field where the State agency finds that such actions will destroy wells and create waste of reserves in the ground, etc., etc., etc.,

reason for the decision of Congress to leave regulation of this function to the States.[37]

D. The Use Of The "Ordinary Prudent Operator" Rule As A Standard For Regulation.

In addition to the question whether the Commission has jurisdiction over production, in the guise of preventing a decline in "service",[38] CEC raises the issue whether, assuming the Commission does have jurisdiction, the proper standard of regulation should be the "ordinary prudent operator" standard adopted by Order No. 539-B or the "certificated minimum daily quantity" standard imposed by Order Nos. 539 and 539-A. CEC objects to the prudent operator standard on the grounds of "vagueness" and "unpredictability" (Br. pp. 43-49). What the Commission finally appreciated, though CEC still does

37. Under the *Outer Continental Shelf Lands Act* of August 7, 1953, the Bureau of Land Management of the Department of Interior has established regulations which control development of OCS leases, and require the lessee to "exercise reasonable diligence" in development and production operations, see 47 C.F.R. §§ 3307.3-2, 3307.3-4.

38. *Pennsylvania Water and Power Co. v. F.P.C.*, 343 U.S. 414 (1952) relied on by CEC (Br. pp. 35, 36) is clearly inapposite to gas producers. An electric utility may create new electric power in many ways, using gas, oil, coal or uranium as fuel. It is guaranteed the opportunity to recover its individual costs, whatever they may be, plus a return, as well as a guaranteed market. A gas producer's ability to "serve" on the other hand, is limited by the ability of his gas reservoirs to produce, and he has no right to increase his price to recover the cost of unsuccessful operations.

not, was the fact that every gas reservoir declines in deliverability over its life (see diagram at Appendix A and discussion, *supra*). Therefore, if a "predictable" standard were established, it would be certain to be violated at some point in the life of the field. This problem is not avoided, as CEC suggests, by fixing a "range" within which a decline in deliveries would be permitted. Rates of decline in reservoirs vary widely, frequently outside of predictable "ranges." Therefore, the insertion of specific numbers in a standard, instead of a standard based on reasonableness, does not reduce litigation or make the Commission's role any simpler or more precise.

Even though the standard adopted by the Commission is the same as that utilized by State Conservation Agencies and State Courts in enforcing the implied covenant which the lessee/producer has to his lessor, the application of that standard to a specific fact situation may be very different.[39] But even more importantly, the *remedy* imposed by the Commission would be different than that imposed by the State Court in a lawsuit by the lessor. The relief granted in a suit for breach of implied covenant is cancellation of the lease.[40] The remedy presumably imposed by the Commission would be a requirement that the producer drill additional wells or take some other action designed to maintain or increase the deliverability of the reservoir. If the chances of success of such an operation were good, Commission action would be unnecessary, as the normal economic interest of the producer would have induced him to drill the well in any event. It is in situations where the

39. See n. 37, supra.

40. 5 H. Williams and C. Meyers, *Oil and Gas Law*, § 806.

chance of success is small, and risk of failure high, that the lessee will refuse to invest his capital in what he believes to be a losing venture. In such a case, the inclination of the Commission will be to require the well, in the interest of "maintaining service" or "expanding supplies". If the producer was correct, and the well is unsuccessful, he has no opportunity to recover his lost capital in the rate for the gas he sells, as those rates are fixed by Commission ceilings and the NGPA.

E. The Commission's Asserted Jurisdiction Cannot Apply To Certificates Issued Prior To Order No. 539.

The Commission claims the power, not only to impose certificate conditions in producer certificates issued after the date of the Opinions below stating the producers' "delivery obligations", under its conditioning power in Section 7(e) of the Act,[41] but *in addition*, claims the authority to impose a similar requirement in *existing* certificates (Br. p. 36). The Commission claims this power to be "implicit" from the Act itself, *even though the certificate gave no hint* that the Commission claimed such awesome power (Order No. 539-B, A. 21a).

Assuming *arguendo*, that the Commission is correct in its position that Section 7 of the Act has destroyed the "production and gathering" exclusion under Section 1(b), this does not mean that the Commission can impose such far-reaching jurisdiction retroactively. This Court

41. This Court said in *Sunray, supra*: "... once the want of power to do this directly were established, the existence of power to achieve the same end through the conditioning power [under Section 7(e)] might well be doubted . . ." (364 U.S. at 152). See also *Central West Utility Co. v. F.P.C.*, 247 F.2d 306, 310-311.

has clearly defined the right of the producer to exercise a conscious decision whether to accept a certificate in which the Commission has imposed conditions on the service which are different than those proposed in the application, *Atlantic Refining Company v. Public Service Commission of New York, (CATCO)*, 360 U.S. 378, 387-388; *Sunray Mid-Continent Oil Co. v. F.P.C.*, 364 U.S. 137, 141. In order to make this decision, the producer is entitled to know what those conditions are. The Commission cannot, consistent with *CATCO* and *Sunray*, impose conditions retroactively, many years after the certificates have been issued, accepted, and service commenced under them, on the grounds that such conditions were somehow "implicit" from the beginning. The very case on which the Commission bases its argument, *Sunray, supra,* would have permitted the producer to decline the unlimited term certificate offered by the Commission, had he chosen to do so. A major change in policy, even where authorized by statute, cannot be given retroactive effect, *Farmers Union Central Exchange, et al. v. F.E.R.C.*, ___F.2d___, Case No. 76-2138, C.A.D.C., decided June 27, 1978.

F. The "End Result"[42] Of The Enforcement Of Either Standard By the Commission Is Litigation, Chaos, And Declining Gas Supplies.

The inevitable result of CEC's proposed standard, instead of a "few time-consuming and complex proceedings" (Br. p. 47), is a *multitude* of time-consuming and

42. This is the ultimate test of the Commission's actions, see *Permian Basin Area Rate Cases*, 390 U.S. 747, 769 (1968); *Mobil Oil Corp. v. F.P.C.*, 417 U.S. 283, 307 (1974).

complex proceedings, as the Commission seeks to "second-guess" the decisions of the producer and State Agency on the best way to develop and produce the reservoir.

Thus, the "end result" of the imposition of Commission regulation over producer, whether under the "prudent operator" or "minimum DCQ" standard, will be exactly the opposite of that assumed by CEC, APGA, and Senior Citizens. Instead of forcing producers to deliver some supplies which are being withheld as these parties erroneously assume, more producers will spend their resources defending their production decisions on existing fields, rather than devoting their efforts to discovering new reserves. The ultimate loser will be the very consumers whose interests these parties purport to represent.

V. CONCLUSION

The Court of Appeals has correctly construed Section 1(b) of the Act and the earlier cases of this Court as excluding production activities from the jurisdictional reach of the Commission. This is true whether the jurisdiction is sought to be imposed directly, or indirectly in the guise of regulating "service" by the producer. Its decision should be affirmed.

Respectfully submitted,

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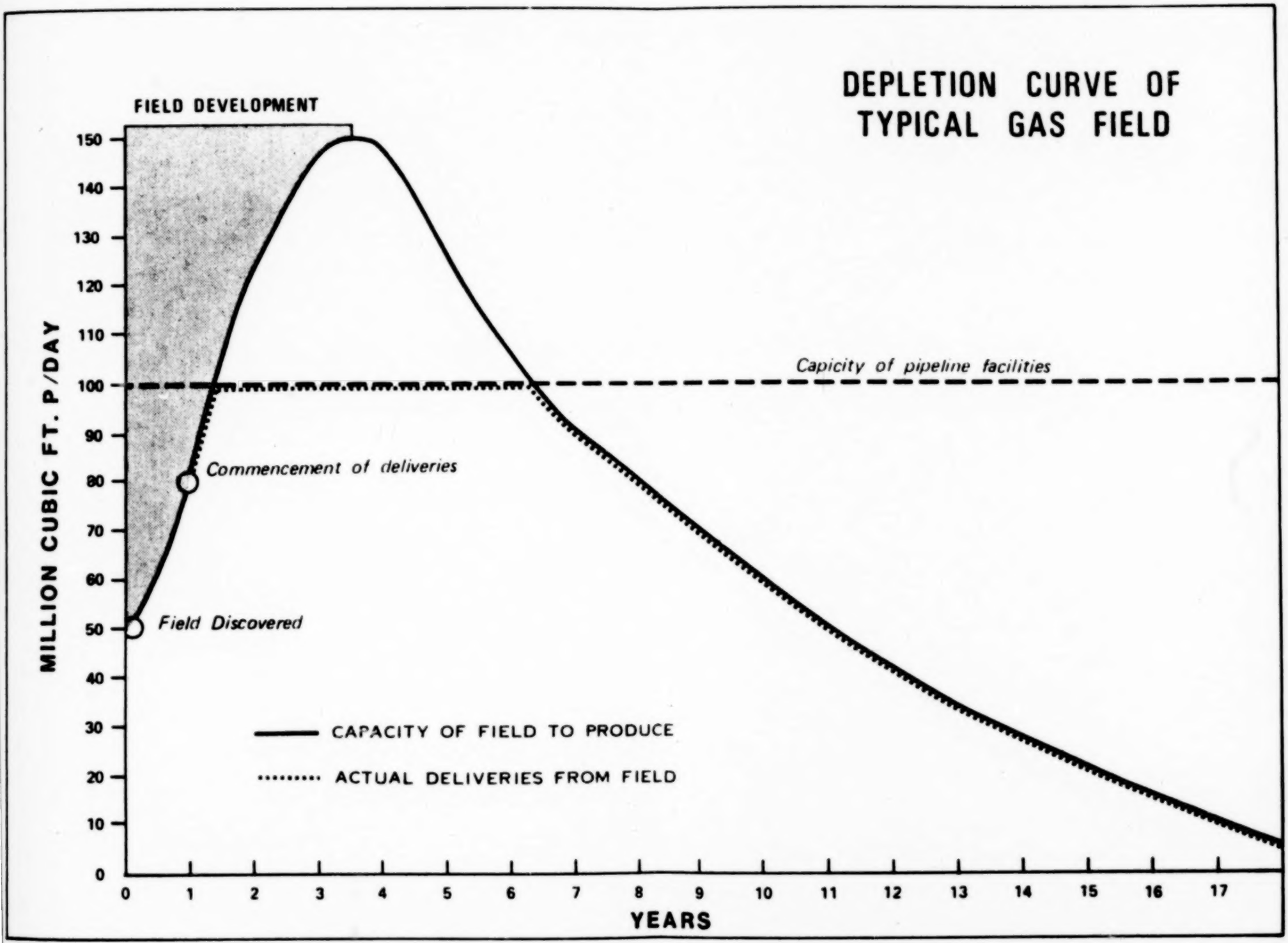
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DEPLETION CURVE OF
TYPICAL GAS FIELD
FIELD DEVELOPMENT
MILLION CUBIC FT. P/DAY
150
140
130
120
110
100
90
80
70
60
50
40
30
20
10
0
Capicity of pipeline facilities
Commencement of deliveries
Field Discovered
CAPACITY OF FIELD TO PRODUCE
ACTUAL DELIVERIES FROM FIELD
0
1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
YEARS

APPENDIX B

Table 1
UNITED STATES GAS SUPPLY-DEMAND BALANCE
Actual 1966-1970; Projected 1971-1990
(All Volumes in Trillions of Cubic Feet @ 14.73 Psia and 60° Fahrenheit)

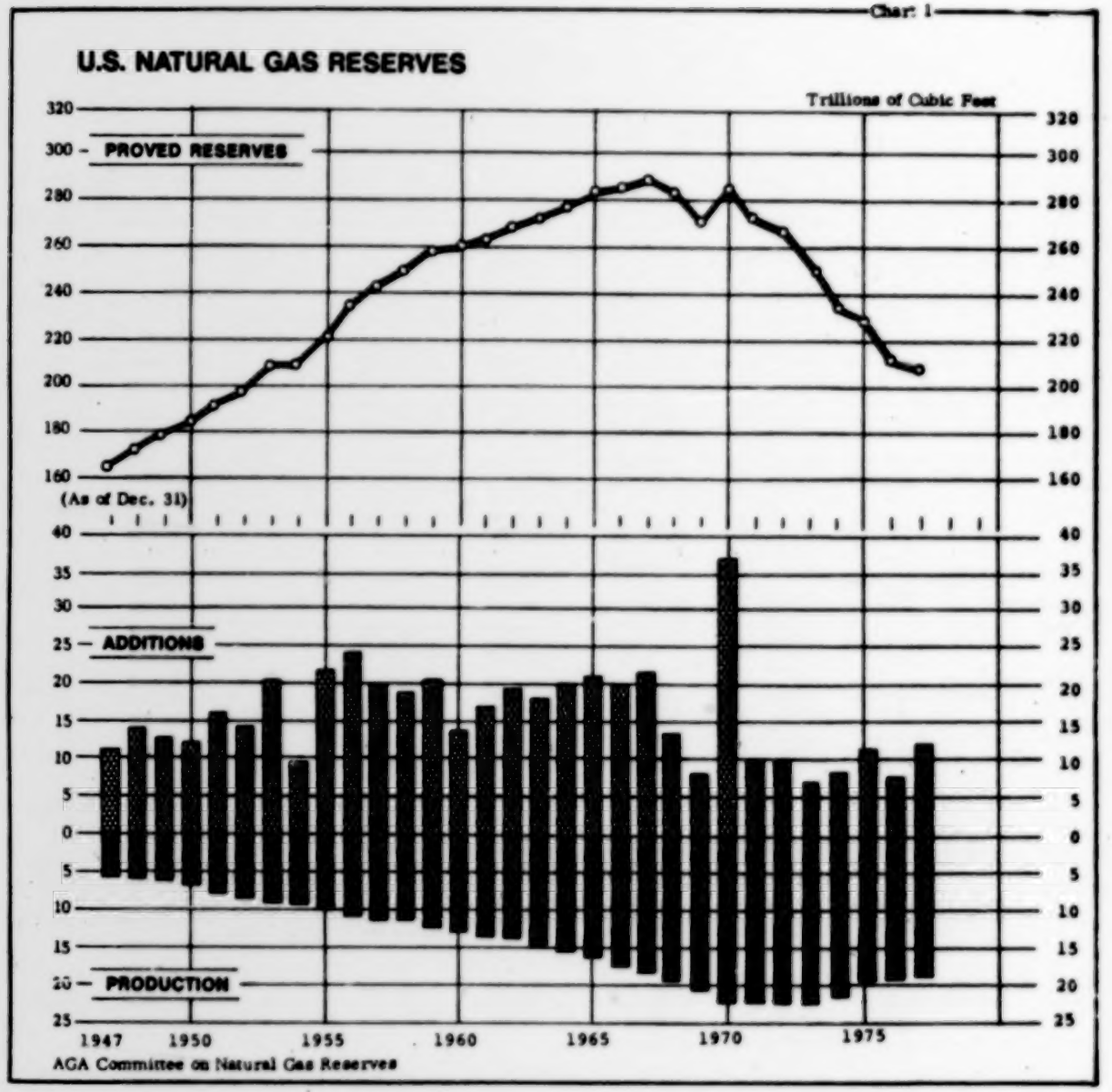
Year	Annual Demand 1/	Net Pipeline Imports	LNG Imports	Gas From Coal	Gas From Alaska	Gas From Liquid Hydrocarbons	Domestic Production	Annual Consumption	Unsatisfied Demand	Reserve Additions	Year-end Reserves	R/P Ratio
1966	17.9	0.4	-	-	-	-	17.5	17.9	0.0	19.2	286.4	16.4
1967	18.8	0.5	-	-	-	-	18.4	18.8	0.0	21.1	289.3	15.8
1968	19.9	0.6	*	-	-	-	19.3	19.9	0.0	12.0	282.1	14.6
1969	21.3	0.7	*	-	-	-	20.6	21.3	0.0	8.3	269.9	13.1
1970	22.6	0.8	*	-	-	-	21.8	22.6	0.0	11.1	259.6	11.9
1971	24.6	0.9	*	-	-	-	22.8	23.7	0.9	12.0	248.8	10.9
1972	26.1	1.0	*	-	-	oo	23.8	24.8	1.3	13.0	238.0	10.0
1973	27.7	1.1	*	-	-	oo	24.7	25.8	1.9	14.0	227.3	9.2
1974	28.8	1.1	*	-	-	oo	24.8	25.9	2.9	15.0	217.4	8.8
1975	29.8	1.2	0.3	-	-	oo	24.7	26.2	3.6	16.0	208.7	8.4
1980	34.3	1.6	2.0	0.3	0.7	oo	20.4	25.0	9.3	17.0	186.1	9.1
1985	39.8	1.9	3.0	1.4	1.3	oo	18.5	26.1	13.7	17.0	173.4	9.5
1990	46.4	1.9	4.0	3.3	2.3	oo	17.8	29.3	17.1	17.0	170.4	9.6
1971-1990 Totals	707.6	31.1	36.0	17.3	20.6	oo	414.2	521.2	186.4	323.0	-	-

* Very small volumes
oo Insufficient data for quantitative projection; unsatisfied demand will be reduced by the amount of SNG actually produced.
1/ Contiguous 48 states.

Source: Placid Oil Company v. F.P.C., 483 F.2d 880, 895.

APPENDIX C

Chart 1



Source: Reserves of Crude Oil, Natural Gas Liquids, and Natural Gas in the United States and Canada as of December 31, 1977, published by the American Gas Association.

APPENDIX D

Table - 5 INTERSTATE PIPELINE COMPANIES
CHANGES IN GAS RESERVES 1/

(ALL VOLUMES .N MILLIONS OF CUBIC FEET (MMCF) AT 14.73 PSIA @ 60 F)

YEAR	ITEM 2/	GAS RESERVES 1ST OF YEAR	REVISIONS 3/ & ADDITIONS GAIN OR LOSS	ANNUAL PRODUCTION	GAS RESERVES YEAR-END	4/ GC/P RATIO	R/P RATIO	ANNUAL 5/ NEW SUPPLY RESERVES	ANNUAL 5/ ADDITIONS PRODUCTION
1963	RESERVES 12-31-63			9,350,628	188,540,057				
1964	RESERVES 12-31-63	188,540,057	5,853,473	9,957,148	184,436,382				
	NEW SUPPLY 1964		4,786,469	57,427	4,729,042			4,786,178	57,427
	TOTAL	188,540,057	10,639,942	10,014,575	189,165,424	1.06	18.9		
1965	RESERVES 12-31-63	184,436,382	2,067,648	10,085,473	176,418,557				
	NEW SUPPLY 1964-1965	4,729,042	11,214,491	285,302	15,658,231			10,193,245	70,881
	TOTAL	189,165,424	13,282,139	10,370,775	192,076,788	1.28	18.5		
1966	RESERVES 12-31-63	176,418,557	1,373,299	10,448,488	167,343,368				
	NEW SUPPLY 1964-1966	15,658,231	12,816,801	688,078	27,786,954			10,130,962	76,977
	TOTAL	192,076,788	14,190,100	11,136,566	195,130,322	1.27	17.5		
1967	RESERVES 12-31-63	167,343,368	4,347,268	10,630,630	161,060,006				
	NEW SUPPLY 1964-1967	27,786,954	10,403,584	1,189,381	37,001,157			9,032,337	72,259
	TOTAL	195,130,322	14,750,852	11,820,011	198,061,163	1.25	16.8		
1968	RESERVES 12-31-63	161,060,006	1,023,867	10,706,018	151,377,855				
	NEW SUPPLY 1964-1968	37,001,157	8,429,100	1,846,079	43,584,178			6,273,690	55,709
	TOTAL	198,061,163	9,452,967	12,552,097	194,962,033	.75	15.5		
1969	RESERVES 12-31-63	151,377,855	143,023-	10,840,598	140,394,234				
	NEW SUPPLY 1964-1969	43,584,178	6,223,648	2,592,790	47,215,036			6,231,721	56,197
	TOTAL	194,962,033	6,080,625	13,433,388	187,609,270	.45	14.0		
1970	RESERVES 12-31-63	140,394,234	2,341,557-	10,728,210	127,324,467				
	NEW SUPPLY 1964-1970	47,215,036	2,379,815	3,363,573	46,231,278			9,458,783	71,652
	TOTAL	187,609,270	38,258	14,091,783	173,555,745		12.3		
1971	RESERVES 12-31-63	127,324,467	179,918	10,446,522	117,057,863				
	NEW SUPPLY 1964-1971	46,231,278	1,810,815	3,758,568	44,283,525			2,191,811	43,734
	TOTAL	173,555,745	1,990,733	14,205,090	161,341,388	.14	11.4		
1972	RESERVES 12-31-63	117,057,863	3,247,027-	10,236,911	103,573,925				
	NEW SUPPLY 1964-1972	44,283,525	3,018,223	3,970,026	43,331,722			5,001,475	111,256
	TOTAL	161,341,388	228,804-	14,206,937	146,905,647	.02-	10.3		
1973	RESERVES 12-31-63	103,573,925	711,183-	9,408,800	93,453,942				
	NEW SUPPLY 1964-1973	43,331,722	1,803,192	4,271,583	40,863,331			1,740,271	74,173
	TOTAL	146,905,647	1,092,009	13,680,383	134,317,273	.08	9.8		
1974	RESERVES 12-31-63	93,453,942	1,216,464-	8,608,922	83,628,556				
	NEW SUPPLY 1964-1974	40,863,331	406,843	4,356,128	36,914,046			2,399,584	81,653
	TOTAL	134,317,273	809,621-	12,965,050	120,542,602	.06-	9.3		
1975	RESERVES 12-31-63	83,628,556	1,294,284-	7,574,784	74,759,488				
	NEW SUPPLY 1964-1975	36,914,046	440,114-	4,416,964	32,056,968			1,478,833	106,971
	TOTAL	120,542,602	1,734,398-	11,991,748	106,816,456	.14-	8.9		
1964-1975	RESERVES @ 12-31-63	188,540,057	5,891,935	119,672,504	74,759,488				
	NEW SUPPLY 1964-1975		62,852,867	30,795,899	32,056,968			62,938,870	878,869
	TOTAL	188,540,057	68,744,802	150,468,403	106,816,456	.46			

1/ SOURCE: FORM 15 REPORTS ADJUSTED TO ELIMINATE DUPLICATIONS.

2/ ITEM "RESERVES @ 12-31-63" REPRESENTS TOTAL RESERVES AND PRODUCTION FOR ALL GAS SUPPLY SOURCES REPORTED AS OF YEAR-END 1963 AND THE ANNUAL CHANGES IN RESERVES AND PRODUCTION FOR THESE SAME GAS SUPPLY SOURCES.
ITEM "NEW SUPPLY..." SHOWS THE YEAR-END RESERVES, ANNUAL PRODUCTION AND CHANGES IN RESERVES FOR ALL NEW SOURCES OF SUPPLY REPORTED IN FORM 15 SINCE 1963.

3/ THE ARITHMETICAL DIFFERENCES BETWEEN THE CURRENT YEAR-END RESERVES PLUS PRODUCTION AND THE PREVIOUS YEAR-END RESERVES.

4/ RATIO OF "REVISIONS AND ADDITIONS" TO "ANNUAL PRODUCTION".

5/ NEW SUPPLY (FIELD OR PLANT) REPORTED FOR THE FIRST TIME IN THE YEAR SHOWN IS COMPILED ON A COMPANY BY COMPANY BASIS AND DOES NOT INCLUDE NEW RESERVOIRS OR NEW DEDICATION IN FIELDS OR PLANTS REPORTED IN THE PREVIOUS YEAR. VOLUMES REPORTED AS RESERVES REPRESENT YEAR-END RESERVES PLUS THE PRODUCTION FOR THAT YEAR.

Source: The Gas Supplies of Interstate Natural Gas Pipeline Companies 1975, published by the Federal Power Commission, Bureau of Natural Gas, January 1977.

FOR ARGUMENT

Supreme Court, U. S.
FILED
DEC 20 1978
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 77-1652

FEDERAL ENERGY REGULATORY COMMISSION, *Petitioner*,

v.

SHELL OIL COMPANY, ET AL., *Respondents*,

No. 77-1654

CONSUMER FEDERATION OF AMERICA,
ENERGY POLICY TASK FORCE, *Petitioner*,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF RESPONDENT STATE OF LOUISIANA

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TABLE OF AUTHORITIES CITED

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United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392 (1965)	7

STATUTES:

Natural Gas Act	
Section 1(b), 15 U.S.C. § 717(b)	4
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Respondent.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

BRIEF OF RESPONDENT STATE OF LOUISIANA

Respondent State of Louisiana (Louisiana) submits the following brief in response to briefs filed by the Federal Energy Regulatory Commission (Commission)

and the Consumer Federation of America, Energy Policy Task Force, and the briefs *amicus curiae* submitted on behalf of Associated Gas Distributors (AGD) and Action Alliance of Senior Citizens of Greater Philadelphia.

QUESTION PRESENTED

Whether the Natural Gas Act precludes the Commission from regulating the physical activities of natural gas production by establishing a "prudent operator" standard in certificates of public convenience and necessity authorizing sales of natural gas in interstate commerce.

STATEMENT OF THE CASE

In the interest of brevity, Louisiana will not recount the procedural history of this proceeding, an undertaking which will be performed by other respondents. The opinions below and jurisdiction of this Court are correctly set forth in the Commission's brief.

ARGUMENT

The "Production or Gathering" Exclusion of the Natural Gas Act Precludes the Commission from Adopting Order No. 539-B and Thereby Regulating the Physical Activities of Natural Gas Production

Despite the fact that the "prudent operator" standard relates to the day-to-day physical activities of natural gas production,[1] the Commission argues that

[1] Order No. 539-B states that:

> This standard encompasses the obligations to develop the properties consistent with the performance requirements of lease agreements with mineral owners and/or assignors; all valid rules and regulations of any Federal, state or local government having jurisdiction; and the standard of what a reasonably prudent producer would do with respect to the drilling, completion, workover, recompletion or abandonment of wells. (Commission Pet. App. at 20(a), footnote omitted).

the "production or gathering" exclusion in section 1(b) of the Natural Gas Act does not prohibit the inclusion of the standard in certificates issued by the Commission to producers. The Commission's interpretation of the Act extends the scope of the Commission's authority beyond that intended by Congress. The Commission's position is based solely on the unsupported theory that the power to enforce a "prudent operator" standard is somehow implied in the Commission's jurisdiction over sales for resale of gas pursuant to section 1(b) of the Act.[2]

The Commission's theory not only awards more authority to the Commission than Congress intended that it should have but also vitiates the congressional intent that the states should retain control over the physical activities of natural gas production. The "production or gathering" exclusion is not "superfluous." (Commission Brief at 25). It is the underpinning of the dual regulatory scheme which Congress envisioned when it passed the Act.[3] Indeed, a review

[2] The Commission makes no effort to disguise the fact that its position implies that it has authority over acts which relate solely to the physical processes of production. It states that it has "some jurisdiction over the physical acts of the producer and the physical operation of the facilities by which certificated service is rendered." (Commission Pet. at 8-9). AGD also argues that, despite the explicit language exempting "production or gathering" of natural gas, the Commission has authority to scrutinize licensees' "production activities." (Brief at 5).

[3] Furthermore, since this Court has interpreted the meaning of the production or gathering exclusion, the language would appear to be something more than "superfluous." Colorado Interstate Gas Co. v. FPC, 324 U.S. 581, 603 (1945).

of the Act and this Court's decisions establishes that the exclusionary language, far from being superfluous, is fundamental to the regulatory system Congress intended to create.

Section 1(b) of the Act sets forth the scope of the Commission's jurisdiction. That jurisdiction is limited to:

> . . . the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate consumption for domestic, commercial, industrial or any other use, and to natural-gas companies engaged in such transportation or sale, . . . 15 U.S.C. § 717(b).

In drafting the Act, Congress took care specifically to withhold jurisdiction from the Commission in certain areas. Thus, section 1(b) of the Act states that the provisions of the Act shall not apply to ". . . the production or gathering of natural gas." 15 U.S.C. § 717(b).

This Court has consistently emphasized that the Act grants *limited* authority to the Commission and that Congress meticulously precluded the Commission from exercising jurisdiction in any but three areas.

> Three things and three only Congress drew within its own regulatory power, delegated by the Act to its agent, the Federal Power Commission. These were: (1) the transportation of natural gas in interstate commerce; (2) its sale in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale. *Panhandle Eastern Pipe Line Company* v. *Public Service Commission,* 332 U.S. 507, 516 (1947).

Additionally, in *FPC* v. *Panhandle Eastern Pipe Line Co.,* 337 U.S. 498 (1949), this Court said:

> Without entering upon another review of its legislative history, suffice it to say that the Natural Gas Act did not envisage federal regulation of the entire natural-gas field to the limit of constitutional power. Rather it contemplated the exercise of federal power as specified in the Act, particularly in that interstate segment which the states were powerless to regulate because of the Commerce Clause of the Federal Constitution. The jurisdiction of the Federal Power Commission was to complement that of the state regulatory bodies. Accordingly, Congress in § 1(b) of the Act not only prescribed the intended reach of the Commission's power, *but also specified the areas into which this power was not to extend.* 337 U.S. at 503. (emphasis added).

An area expressly exempted from the Commission's jurisdiction was "the production or gathering of natural gas." Congress intended that the power to regulate production activities would remain vested in the states and that they would continue to regulate these activities.

In passing the Act, Congress took care not to supplant any authority of the states but rather sought only to regulate the area which the states constitutionally could not reach. Thus, in *Panhandle Eastern Pipe Line Co.* v. *Public Service Commission, supra,* this Court emphasized that:

> The Act, through extending federal regulation, had no purpose or effect to cut down state power. On the contrary, perhaps its primary purpose was to aid in making state regulation effective, by adding the weight of federal regulation to supplement and reinforce it in the gap created by the prior decisions. The Act was drawn with meticulous regard for the continued exercise of state

power, not to handicap or dilute it in any way. 332 U.S. at 517-518.

Further, in *FPC* v. *Panhandle Eastern Pipe Line Co., supra,* this Court stated:

> The legislative history of this Act is replete with evidence of the care taken by Congress to keep the power over the production and gathering of gas within the states. This probably occurred because the state legislatures had delegated broad and elaborate power to their regulatory bodies over all aspects of producing gas. The Natural Gas Act was designed to supplement state power and to produce a harmonious and comprehensive regulation of the industry. *Neither state nor federal regulatory body was to encroach upon the jurisdiction of the other.* Congress enacted this Act after full consideration of the problems of production and distribution. It considered the state interests as well as national interests. 337 U.S. at 509-514. (emphasis added).

The Act specifically preserved the rights which the states could exercise and were exercising when the Act was passed. The assertion of Commission jurisdiction over production activities which Louisiana and the other producing states have regulated for years would be inconsistent with the congressional purpose—often cited by this Court—not to invade the powers or prerogatives of the states.

The Commission argues that the court of appeals incorrectly considered the production or gathering exclusion separately from the affirmative grant of jurisdiction over sales for resale and incorrectly assumed that the exclusion takes precedence. The court of appeals did no such thing. In fact, the court of appeals followed the guidance provided by earlier de-

cisions of this Court and construed the "two relevant clauses" together to further the congressional purpose. In *United Gas Improvement Co.* v. *Continental Oil Co.* (Rayne Field), 381 U.S. 392 (1965), this Court distinguished between sales for resale and production or gathering, but found that the sales of leaseholds in question in that case constituted sales of gas:

> In the context of such a sale, . . . the "production or gathering" exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction. *This accommodation of the two relevant clauses of § 1(b) gives content to the national objectives of the Natural Gas Act as expounded in Phillips, and to the Commission's jurisdiction to accomplish them, while in no way interfering with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate state concerns.* 381 U.S. at 402-403.

The Commission recognizes that Order No. 539-B attempts to govern the physical processes of natural gas production. (Commission Brief at 32-33). On its face, the standard enunciated by the Commission—"what a reasonably prudent producer would do with respect to the drilling, completion, workover, recompletion or abandonment of wells"—is an effort to regulate precisely that which this Court has found the Commission to be powerless to regulate. The Commission simply has ". . . no control over the drilling and spacing of wells and the like." *Colorado Interstate Gas Co.* v. *FPC, supra.*

Some practical problems highlight the degree to which Order No. 539-B ignores and undercuts the dual

federal-state regulatory scheme devised by Congress. The Commission has adopted a standard which it found in the rules and regulations of state conservation agencies.[4] The standard has been interpreted by state courts in resolving questions arising under mineral leases. Each producing state has developed its own body of law surrounding the "prudent operator" standard, and it is doubtful that the standard is uniformly applied in all jurisdictions. More important, there is no assurance that the Commission will always interpret the standard in the same way as do the states. The potential therefore exists for intolerable conflict between state and federal agencies over the proper interpretation of state law. The Commission's brief provides no reassurance that such conflict can be avoided. The Commission states:

> Application of the prudent operator standard to particular cases will depend on the circumstances, but state law and the United States Geological Service regulations will *ordinarily* provide the specific contents of the standard and hence the yardstick against which the producer's performance is measured. (Commission Brief at 32-33). (emphasis added).

It requires little imagination to foresee an "extraordinary" situation which will present a conflict between the Commission and a state agency over the proper interpretation of the "prudent operator" standard. It was in part to avoid the possibility of such conflict that Congress took care to reserve exclusively to the states the power to regulate production activities.

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[4] *See, e.g.*, Title 30, Louisiana Revised Statutes (1950).

CONCLUSION

For the reasons stated above, we respectfully request the Court to allow the decision of the court of appeals to stand.

Respectfully submitted,

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Supreme Court, U. S.
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IN THE

Supreme Court of The United States

OCTOBER TERM, 1978

No. 77-1652

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

SHELL OIL COMPANY, ET AL.,
Respondents.

No. 77-1654

CONSUMER ENERGY COUNCIL OF AMERICA,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF RESPONDENTS TENNECO OIL COMPANY AND PENNZOIL COMPANY

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In The

Supreme Court of The United States

October Term, 1978

No. 77-1652

Federal Energy Regulatory Commission,
Petitioner,

v.

Shell Oil Company, et al.,
Respondents.

No. 77-1654

Consumer Energy Council of America,
Petitioner,

v.

Federal Energy Regulatory Commission,
Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF RESPONDENTS TENNECO OIL COMPANY AND PENNZOIL COMPANY

OPINIONS BELOW AND JURISDICTION

The opinions below are correctly referenced and the jurisdictional prerequisites are adequately set forth in the brief of the Federal Energy Regulatory Commission (Commission).

QUESTION PRESENTED

Whether the Commission has jurisdiction to regulate the production activities of independent producers who sell gas in interstate commerce for resale.

STATUTES INVOLVED

Sections 1(b) and 7(b) of the Natural Gas Act, 15 U.S.C. §717(b) and 717f(b), are correctly set forth in the Commission's Petition for Writ of Certiorari.

STATEMENT

This case presents for review the Commission's Order No. 539-B. By that Order the Commission has undertaken to regulate the production processes and activities of natural gas producers who sell the natural gas they produce in interstate commerce for resale. The Commission has attempted to accomplish this objective in Order No. 539-B by (1) adopting a regulation pursuant to which all certificates for sales by independent producers issued after July 30, 1976 will impose a condition requiring the seller to develop and operate the property from which the gas will be produced as a prudent operator, and (2) asserting that all producer certificates issued prior to July 30, 1976 contain, by implication, an identical condition even though no such condition had theretofore ever been mentioned in any certificate. We believe, as did the Court of Appeals, that the Commission does not have the jurisdictional authority to regulate production processes and activities. Therefore, the Court of Appeals properly vacated Order No. 539-B.

The events which culminated in Order No. 539-B commenced with the issuance of Order No. 539 on October 14, 1975. That Order, which was issued without prior notice or the opportunity for comment by interested parties, added

a new Section 2.83 to the Commission's General Policy and Interpretations. Section 2.83(d) provided that every jurisdictional sale of gas by a producer is made subject to a "certificated minimum daily delivery obligation" and that Commission authorization must be obtained if the amount of gas produced and sold falls below the amount of that "obligation." Under Section 2.83(d), this "certificated minimum daily delivery obligation" was to be expressly stated as a condition in every certificate issued on or after October 14, 1975.

In response to numerous petitions for rehearing, the Commission in Order No. 539-A (issued March 26, 1976) instituted an informal rulemaking proceeding to consider the issues raised by Order No. 539.

After receipt of oral and written comments, the Commission issued Order No. 539-B on July 30, 1976. The Commission determined in that Order that the Section 2.83(d) condition which had been adopted in Order No. 539 was not in the public interest. Section 2.83 was therefore deleted from the Commission's regulations and the Section 2.83(d) condition was deleted from the certificates in which it had been imposed. At the same time, the Commission adopted Section 157.41 of its Rules and Regulations under which every certificate for a jurisdictional sale of natural gas will include, either explicitly or by implication, a condition requiring the seller of gas to operate the properties from which the gas is produced as a "prudent operator". Commissioner Watt dissented from the determination to adopt Section 157.41 and to impose the Section 157.41 condition in individual certificates on the grounds that the Commission does not have the authority to regulate production activities.

On review, the United States Court of Appeals for the Fifth Circuit vacated Order No. 539-B, holding that the Commission has no jurisdiction to regulate production

activities. Specifically, the Court held that Section 1(b) of the Natural Gas Act, as interpreted by this Court, expressly excludes the physical activities of production from the Commission's jurisdiction.

SUMMARY OF ARGUMENT

Section 1(b) of the Natural Gas Act confers on the Commission authority to regulate sales of gas in interstate commerce for resale.[1] However, such jurisdiction does not carry with it the authority to regulate the production of the gas sold. Rather, as Section 1(b) expressly provides, production is an activity separate and distinct from the sale of the gas produced. This critical distinction was recognized in the legislative history of the Natural Gas Act; this critical distinction has also been expressly and repeatedly recognized and carried forward in decisions of this Court, including the landmark decision in *Phillips Petroleum Company* v. *Wisconsin*.[2] Thus, although the Commission may have jurisdiction over the sale, it has no jurisdiction over the production activities preceding such sale.

The Commission suggests that it must have jurisdiction to regulate production in order to prevent a gap in the regulatory framework within which the natural gas industry operates. In fact, production is subject to regulation by both State agencies and federal regulatory bodies other than the Commission, as Congress intended. Regulation of such activities by the Commission would constitute an unauthorized intrusion into the domain of other regulatory bodies in contravention of the specific mandate of Congress.

[1] As a result of the recently enacted Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3352, certain interstate sales for resale are no longer subject to regulation under the Natural Gas Act. The impact of the NGPA on this case is discussed *infra* at 24-26.

[2] 347 U.S. 672 (1954) [hereafter cited as "*Phillips*"].

Recognizing the jurisdictional defect in the Commission's position, the Consumer Energy Counsel of America (CEC), Petitioner in No. 77-1654, launches a more subtle attack on the decision of the Court of Appeals. Conceding that Section 1(b) of the Natural Gas Act may exempt production activities by producers from the regulatory purview of the Commission (CEC Br. at 25-26), CEC contends that the Commission nevertheless can regulate such activities through imposition of a service obligation under Section 7 of the Natural Gas Act. However, the argument is circular. Imposition of a service obligation under Section 7 is necessarily premised upon an assumption that the Commission has been delegated the jurisdiction under Section 1(b) to impose such an obligation. Section 7 is not an independent delegation of authority but rather an enabling provision to allow the Commission to effectuate its Section 1(b) jurisdiction.[3]

ARGUMENT

I.

THE COMMISSION DOES NOT HAVE JURISDICTION TO REGULATE PRODUCTION ACTIVITIES

The Commission concedes that Order No. 539-B is an assertion of jurisdiction over the production activities of independent producers. Thus, the Commission acknowl-

[3] The second issue raised by CEC, the propriety of the "prudent operator standard," is not briefed herein. Because of its determination that the imposition of any standard governing production was beyond the Commission's jurisdiction, the Court of Appeals never considered the propriety of the standard imposed. In the event the Court of Appeals' decision is vacated, this issue should be remanded to the Court of Appeals for its review and determination, since it is the Court vested by Congress with the primary supervision of Commission actions. *E.g., Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 309-10 (1974). The issue not being ripe for review, Respondents Tenneco Oil Company and Pennzoil Company have not addressed it herein.

edged in Order No. 539-B that it was undertaking to regulate "... what a reasonably prudent *producer* would do with respect to the *drilling, completion, workover, recompletion or abandonment of wells*" (Comm. Pet. at 20a; emphasis added). Again, in its Petition for a Writ of Certiorari, the Commission recognized that its claimed jurisdiction under Order No. 539-B would allow it to oversee and regulate the normal operation and maintenance of individual wells (Comm. Pet. at 16). Finally, in its brief to this Court, the Commission asserts that it has power to determine and direct the steps to be taken by a producer in maintaining its wells and developing it leases, and that Order No. 539-B is an exercise of that authority (Comm. Br. at 22).

Thus, the Commission has not attempted to justify its order by suggesting that it is not an assertion of jurisdiction over production activities. Instead, the Commission attempts to justify its position on the grounds that jurisdiction over production activities is a necessary incident of its jurisdiction to regulate sales by producers.

Consequently, the issue in this case is clear cut and directly posed: Does the Commission's jurisdiction under Section 1(b) of the Natural Gas Act to regulate sales by producers in interstate commerce for resale carry with it the jurisdiction to regulate production of the gas which is sold? The answer is just as clear: the Commission has *no* jurisdiction over production processes or activities.

A. Section 1(b) of the Natural Gas Act, As Interpreted In The Phillips Decision, Precludes Commission Jurisdiction Over Production Activities.

The determinative authorities in this case are (1) Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b), and (2) this Court's decision in *Phillips*. Section 1(b) is the source of all of the Commission's jurisdiction under the

Natural Gas Act. The *Phillips* decision delineates the bounds of that jurisdiction over independent producers.

Section 1(b) not only grants jurisdiction over specified activities, but also makes clear as a statutory matter the activities that are not included within the jurisdiction granted. Thus, Section 1(b) confers on the Commission jurisdiction over (1) transportation of natural gas in interstate commerce; (2) the sale of natural gas in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale.[4] At the same time, Section 1(b) specifically provides that the provisions of the Natural Gas Act "shall not apply ... to the production of ... natural gas."

It is therefore clear that Congress in enacting the Natural Gas Act viewed the sale of natural gas as an activity separate and distinct from the production of that gas. Accordingly, Congress provided jurisdiction over the former but not the latter. Indeed, that is precisely the underlying basis upon which this Court in the *Phillips* decision concluded that the Commission had jurisdiction over sales by independent producers.

In *Phillips* the producers and the Commission contended that the sale of gas by an independent producer was incident to the production of the gas sold. They therefore contended that the affirmative grant over sales could not be interpreted as encompassing sales by producers because production (and the sale incident thereto according to the producers and the Commission) was excluded from the Commission's jurisdiction.

This Court rejected that contention, holding that sales by independent producers are subject to regulation under

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[4] *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949); *accord, FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972).

the Natural Gas Act. The basis for that holding was the determination that, as used in the Natural Gas Act, production is an activity separate and apart from the sale of the gas produced. As stated by the Court:

> ... production and gathering, in the sense that those terms are used in § 1(b) [of the Natural Gas Act], ended before the sales ... occur.[5]

Thus, this Court in *Phillips* held that the production exclusion did not preclude Commission jurisdiction over sales by producers because the sale of gas by a producer is not an incident of its production.

The instant case is simply the mirror-image of *Phillips*. If the sale of gas is not an incident of its production so that the sale by producers is not encompassed by the production exclusion, then conversely, the production of gas is not an incident of its sale. Thus, jurisdiction over production activities cannot be said to have been granted as an incident of jurisdiction over sales by independent producers. Instead, as this Court held in *Phillips,* the production of gas by a producer, and the subsequent sale of such gas by a producer, are two separate and distinct activities. Gas subject to the Natural Gas Act cannot be sold in interstate commerce for resale except as permitted by the Commission. The production of the gas is a matter totally beyond the Commission's jurisdiction, however.

B. The Legislative and Judicial History Confirms The Commission's Lack of Jurisdiction Over Production Activities.

The legislative history of the Natural Gas Act, as discussed in *Phillips,* is relied upon by both the Commission and CEC as support for their assertion that the Commission has jurisdiction over production activities under the

[5] 347 U.S. at 678.

Natural Gas Act. Petitioners assert that the legislative history shows that the "production and gathering" exclusion had no intended meaning, since the words were stated to be "not actually necessary." Therefore, they argue, the exclusion cannot be used to restrict the jurisdictional delegation of authority contained in Section 1(b) of the Act.

However, an examination of the actual legislative history relied upon by Petitoners reveals that exactly the opposite is the case. As set forth in *Phillips,* after quoting the provision of Section 1(b) which provides that the Natural Gas Act does not apply to production activities (as well as other specified activities), the committee report on the bill which became the Natural Gas Act states as follows:

> The quoted words are not actually necessary, as the matters specified therein could not be said fairly to be covered by the language affirmatively stating the jurisdiction of the Commission....[6]

In other words, the production "exclusion" is not really an exclusion at all because production does not come within and cannot fairly be read as coming within any of the jurisdictional delegations contained in Section 1(b). Thus, the Natural Gas Act's legislative history makes clear what is already apparent from the very words of the Act: the legislative delegation of jurisdiction over sales of natural gas does not include a grant of jurisdiction to regulate the production of the gas so sold.

The legislative history of the Natural Gas Act is pertinent for yet another reason. As discussed in *Phillips:*

> There can be no dispute that the overriding congressional purpose was to plug the "gap" in regulation of natural-gas companies resulting from judicial decisions prohibiting, on federal constitutional grounds, state

[6] *Id.* at 683.

> regulation of many of the interstate commerce aspects of the natural-gas business.[7]

Specifically, sales in interstate commerce for resale had been deemed to be beyond state regulatory powers even when Congress had not occupied the field. *See Public Util. Commission* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927); *Missouri* v. *Kansas Natural Gas Co.*, 265 U.S. 298 (1924). As stated in the committee report on the bill that became the Natural Gas Act:

> The basic purpose of the present legislation is to occupy this field in which the Supreme Court has held that the States may not act.
>
> • • • •
>
> The bill takes no authority from State Commissions, and is so drawn as to complement and in no manner usurp State regulatory authority....[8]

As clearly as the *Kansas Gas* and *Attleboro Steam* cases resulted in the gap that was to be closed by the passage of the Act in 1938,[9] this Court's 1931 decision in *Champlin Refining Co.* v. *Corporation Commission*, 286 U.S. 210 (1931), makes clear there was no regulatory gap with respect to production activities. In *Champlin*, this Court rejected the contention that the states are powerless to regulate the production of a commodity thereafter sold in interstate commerce, stating:

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[7] *Id.* at 682-83 (footnote omitted).

[8] H.R. REP. No. 1162, 75th Cong., 1st Sess. 2 (1937).

[9] CEC's reliance upon *Interstate Natural Gas Co.* v. *FPC* 331 U.S. 682 (1947) is wholly unfounded. That case specifically involved a situation in which the Petitioner in that case had tried to create a gap notwithstanding the passage of the Natural Gas Act. As noted at p. 687 n. 9 of that decision, that Petitioner had asserted that the state had no power to regulate the sale because it was in interstate commerce at the same time that it was arguing to the Commission that it did not have any jurisdiction over the sale.

> It is clear that the regulations prescribed and authorized by the [state] commission apply only to production and not to sales or transportation of crude oil or its products. Such production is essentially a mining operation and therefore is not a part of interstate commerce even though the product obtained is intended to be and in fact is immediately shipped in interstate commerce.[10]

Thus, as of 1938 — when the Gas Act was passed — this Court had drawn the basic distinction between the activities of production of products subsequently sold in interstate commerce and the sale of the products so produced. Indeed, this distinction was so sharp as to provide the basis for a difference in this Court's view of the state's powers with respect to such activities. According to *Champlin*, the states had the power to regulate production of products to be sold interstate. However, according to *Attleboro Steam* and *Kansas Gas*, the states did not thereby accrue the power to regulate sales in interstate commerce of the commodity produced.

This distinction between production and sale, and the treatment of the two activities as being separate and distinct, was expressly incorporated into the Natural Gas Act. The activities which this Court had held to be beyond state authority, wholesales of natural gas in interstate commerce, were subjected to Federal regulation. And because the basic purpose of the Natural Gas Act was simply to bring under Federal regulation matters which were beyond state control, those matters which were not beyond state control, such as production activities, were expressly excluded from the Commission's jurisdiction. The Commission's contention to the contrary ignores not only the plain words of the statute, but the legislative and judicial history underlying the Natural Gas Act as well.

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[10] 286 U.S. at 235.

C. This Court Has Consistently Affirmed The Validity of the Production Exemption.

This Court's determination in *Phillips* that production is an activity separate and distinct from sale of the gas produced so that the grant of sales jurisdiction cannot and does not carry with it authority over production activities is consistent with this Court's treatment of Section 1(b) both before and after *Phillips*. Thus, in *Colorado Interstate Gas Co.* v. *FPC*,[11] this Court described the reach of the production exemption as follows:

> Certainly that provision precludes the Commission from any control over the activity of producing or gathering natural gas. For example, it makes plain that the Commission has no control over the drilling and spacing of wells and the like.[12]

This Court again addressed the meaning of the Section 1(b) production exemption in *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949). The Court first recognized that Section 1(b) contains not only a grant of jurisdiction, but also expressly identifies areas not included within the jurisdictional grant. Among the activities which the Court recognized as being expressly excluded from the Commission's jurisdiction is ". . . the production and gathering of natural gas."[13] Referring to the scope of the production exemption as set forth in *Colorado Interstate*, the Court once again adhered ". . . to this natural and clear meaning of the words and their obvious expression of congressional intent."[14] Indeed, in *Panhandle* the Commission itself expressly recognized in its argument to the Court that "the activities of production and gathering,

[11] 324 U.S. 581 (1945).

[12] *Id.* at 602-3.

[13] 337 U.S. at 504.

[14] *Id.* at 504-5.

such as drilling, spacing wells, or collecting gas . . . were excluded from the coverage of the Act."[15]

Finally, in *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965) (the *Rayne Field* case), this Court again reiterated the distinction between the production and the sale of natural gas. There, the Court concluded that merely because the gas was sold before production — being a sale of gas in place — the Commission did not thereby lose its jurisdiction to control the price at which such gas was sold. Under the Court's analysis, the Commission had price jurisdiction over the sale without regard to the timing of the transactions, i.e., whether the sale occurred before, during, or after production. However, the Court made clear that this in no manner interfered with or nullified the statutory preclusion of Commission jurisdiction over production activities. As stated by the Court:

> [T]he "production or gathering" exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction. This *accomodation* of the two relevant clauses of § 1(b) gives content to the national objectives of the Natural Gas Act as expounded in Phillips, and to the Commission's jurisdiction to accomplish them, while in no way interfering with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate state concerns.[16]

Thus, the Court's decision in *Rayne Field* carries forward the distinction between production processes and activities, which are subject to state regulation, and sales in interstate commerce, which are not, first set out by this Court before the passage of the Natural Gas Act and consistently recog-

[15] *Id.* at 504.

[16] 381 U.S. at 402-03 (emphasis added).

nized thereafter. Equally importantly, this Court again emphasized in *Rayne Field* the preservation of the states power over production and that accordingly, the affirmative delegation of jurisdiction in Section 1(b) must be *accomodated* with the statutory denial of jurisdiction in the same section, not nullified. Thus, Petitioners' argument that the "production" exemption in Section 1(b) does not limit the affirmative jurisdiction granted thereunder has already been rejected by this Court and should again be rejected in the instant case.

D. Section 7(b) Does Not Confer Jurisdiction Over Production Activities.

As has been set out, the Commission's effort to regulate production activities by claiming that production is an incident of sale is precluded by Section 1(b), the *Phillips* case, the Natural Gas Act's legislative history, and the other consistent holdings of this Court. It is therefore not surprising that both the Commission's and the CEC's brief treat Section 1(b) in a cursory manner and emphasize instead Section 7(b). In this regard, the Commission states that it has jurisdiction under Section 7(b) to prevent the termination of service without prior Commission authorization being obtained. The Commission relies on *Sunray Mid-Continent Oil Co.* v. *FPC,* 364 U.S. 137 (1960) and *California* v. *Southland Royalty Co.,* 98 S. Ct. 1955 (1978).

This general principle adds nothing to the resolution of this case, however. For, as *Sunray* makes clear, Section 7(b) "regulates the abandonment by natural-gas companies of . . . *services subject to the jurisdiction of the Commission.*"[17] Thus, inevitably the inquiry must return to Section 1(b) for that Section is the sole source of the "services subject to the jurisdiction of the Commission."

[17] 364 U.S. at 141.

As established above, the service over which the Commission has jurisdiction is the *sale* of the gas which is produced. Thus, as in *Sunray,* an independent producer cannot, without Commission approval, discontinue *selling* to the interstate purchasers *the gas which is produced* simply because the contract with that purchaser has expired. Nor, according to *Southland,* can a reversionary interest owner terminate the *sales to an interstate purchaser of the gas produced* from acreage at one time covered by a fixed term lease when such lease expires unless Commission authorization is obtained.

On the other hand, the Commission's authority to insure that gas which is produced is *sold* in interstate commerce most assuredly does not carry with it the authority to compel or regulate the rate of production of that gas. For both Congress and this Court have determined that production is not an incident to sale. The Commission's boot-strap attempt to create jurisdiction through Section 7(b) when Section 1(b) confers no such jurisdiction must fail.

Furthermore, any suggestion that the Court of Appeals decision undermines Section 7(b), *Sunray* or *Southland* is simply wrong. The Commission has full authority to compel producers to sell in interstate commerce gas which is produced from dedicated acreage. But it has no authority to compel or direct production activity. That authority was left by Congress to the states.

This is not the first occasion the Commission has attempted to avoid the express exclusion of production from its jurisdiction by attempting to rely on the powers conferred under the non-jurisdictional sections of the Act. Precisely the same argument was made and rejected in *FPC* v. *Panhandle Eastern Pipe Line Co.*[18] The production

[18] 337 U.S. 498 (1949).

activity over which the Commission sought jurisdiction in that case was the transfer by a pipeline company of undeveloped oil and gas leases. In asserting that it did have the requisite jurisdiction despite Section 1(b), the Commission relied on its powers under Sections 4, 5 and 7 of the Act. Specifically, the Commission pointed out that the reserves underlying the leases had been set forth as a part of the gas supply warranting expansions of service under three Section 7 certificates and that Panhandle had included the reserves in its rate base. The Commission argued, just as it does in this case, that its power under Section 7(b) to prevent abandonments conferred jurisdiction over production activities. But this Court pointed out that the powers conferred by Sections 4, 5 and 7 are applicable only to matters over which the Commission has jurisdiction under Section 1(b):

> Sections 4, 5 and 7 do not concern the producing or gathering of natural gas; rather they have reference to the interstate sale and transportation of gas and are so limited by their express terms.
>
> • • • •
>
> Nothing in the sections indicates that the power given to the Commission over natural-gas companies by § 1(b) could have been intended to swallow all the exceptions of the same section and thus extend the power of the Commission to the constitutional limit of congressional authority over commerce. The repetition of the words 'subject to the jurisdiction' makes clear to us the intent to keep the Commission's hand out of the excepted local matters.[19]

Order No. 539-B is an even clearer attempt to circumvent the Section 1(b) production exemption than was the attempt in *Panhandle*. Although unsuccessful, the Commission in *Panhandle* at least attempted to deal with the

[19] *Id.* at 508.

Section 1(b) production exemption by arguing that the exemption applied to the activities of production, but not to the facilities of production, such as leases. In the present case, the Commission has acknowledged that its Order asserts jurisdiction over production activities. Indeed, whether a producer is a "prudent operator" encompasses every phase of the activities of production. This pervasive attempt to strip all meaning from the production exemption makes prophetic this Court's comments as to the inevitable results of endorsing the Commission's position in *Panhandle*:

> To accept these arguments springing from power to allow interstate service, fix rates, and control abandonment would establish wide control by the Federal Power Commission over the production and gathering of gas. It would invite expansion of power into other phases of the forbidden area.[14] It would be an assumption of powers specifically denied the Commission by the words of the Act as explained in the report and on the floor of both houses of Congress.

[14] Would it soon be contended that statutory power to require extension of service, § 7(a), included power to require exploration or acquisition of leases . . . . in order to serve the public interest?[20]

Even without the invitation of "expansion of power into other phases of the forbidden area" which the Court refused to issue in Panhandle, the Commission now asserts that it has authority over the entire forbidden area.

The *ultra vires* nature of the Commission's effort is evident on the face of Section 7 itself. Under Section 7(a), the Commission is delegated the authority to "direct a natural-gas company to extend or improve its *transportation* facilities . . ." (emphasis added). However, the statute nowhere grants the Commission an analogous authority to

[20] *Id.* at 509. (f.n. 15 omitted).

order a "natural-gas company" to extend or improve its *production* facilities. Further, it has been specifically held that even though the Commission has the power to order the extension or improvement of transportation facilities, it has no power to order an enlargement of facilities.[21] Yet the Commission here claims nothing less under Order No. 539-B than the power to order the extension, improvement and enlargement of production facilities. Thus, the Commission's contention is that Congress delegated broader authority over producer activities by its silence in Section 7 than it gave over transportation activities by specific directive. Particularly in light of the exclusionary language in Section 1(b), the Commission's interpretation does violence to the expressed terms of Section 7.

CEC's argument that Congress' refusal to delegate to the Commission jurisdiction over production under Section 1(b) can be overcome by reference to the services obligation imposed by Section 7[22] is similarly uncompelling. CEC's proposed alternate to the Commission's "prudent operator standard" would require a producer to approach the Commission any time it incurs a decline in the level of service under a certificate, however the level of service were defined.[23] This argument is merely an exercise in semantics. Any well suffers a "decline in service" throughout its production history as the reservoir is produced and reserves depleted. No less than the "prudent operator standard," this "service" standard would imbue the Commission with the power to order a producer to extend, improve, or expand its production facilities. Thus, not only does CEC's alternative fail because of the absence of any such authority invested in the Commission

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[21] *See Central West Util. Co.* v. *FPC*, F.2d 306 (3d Cir. 1957).

[22] CEC Brief at 58.

[23] CEC Brief at 58-9.

under Section 7, but it also fails because at bottom, the standard necessarily assumes Commission jurisdiction over production activities in order to exercise its authority.

In short, Section 7 of the Natural Gas Act in no manner expands Commission jurisdiction under Section 1(b). Section 7 is *not* an independent delegation of jurisdiction. Rather, Section 7 only implements, and is therefore delimited by the jurisdictional delegation of power contained in Section 1(b).

E. There Is No Regulatory Gap Involved in the Instant Case.

The Commission and CEC both posit that a regulatory gap arises if the Commission's jurisdiction is not affirmed in the instant case. However, an examination of previous decisions of this Court, legislative enactments subsequent to the passage of the Natural Gas Act, and the standard adopted by the Commission itself reveals that not only is there no regulatory gap, but that the system *without* Order No. 539-B is exactly that contemplated by Congress in enacting the Natural Gas Act.

To put this argument in the proper perspective, it is essential to reiterate the predicate for the Natural Gas Act. That Act was passed to close the hiatus which the courts had found to exist because of constitutional prescriptions against state regulation of interstate commerce. It was not intended to invade the province of the states as to those areas in which they clearly had the power to regulate. Thus, the regulatory scheme under the Natural Gas Act is a bifurcated structure: the states are allowed to regulate activities of producers to the maximum extent contemplated under the Constitution, and federal authority, delegated to the Commission, covers the areas in which the states are constitutionally precluded from regulating.

Even before the Natural Gas Act, this Court in *Champlin* recognized the power of the states to regulate production. It was contemplated under the Natural Gas Act that the states would continue to exercise that function. Indeed, the Commission has effectively conceded the efficacy of the standard — the "prudent operator standard" — by adopting the standard as the basis for assuring that service will be maintained.[24]

Thus, there is no claim that the states do not have a standard which will assure continuation of production in feasible circumstances. Nor is there any claim that the states have not administered that standard properly, as indeed the Commission claims that it will administer the standard in conformity with the interpretation of that standard by the various states.[25] Rather, the Commission merely asserts that its exercise of that power is necessary to administer its responsibilities under the Natural Gas Act. The answer is simply that Congress did not consider it necessary to vest that power in the Commission under Section 1(b) of the Natural Gas Act in order for it to effectuate its power under Section 7. Rather, the states were perceived as having the power to fulfill the underlying production enforcement responsibility which would then enable the Commission to exercise its Section 7 responsibilities. Thus, there is no regulatory gap. However, if the system as contemplated and designed by Con-

[24] Order No. 539-B at 8; Commission Brief at 31.

[25] Comm. Brief at 31-32. This assertion by the Commission disposes of the CEC's claim that the "prudent operator standard" is not necessarily consistent with the concept of service under Section 7 of the Natural Gas Act. CEC's Brief at 39. Obviously, the Commission perceives no such inconsistency between the "prudent operator standard" as enforced by the states and Section 7 service obligations. Indeed, counsel for the Commission conceded before the Court of Appeals that there was no evidence that producers were withholding supplies under the existing system. App. at 3a.

gress is not working, and there is simply no evidence in this proceeding that it is not, then the Commission's remedy is with Congress.[26]

Congress, however, has indicated no dissatisfaction with the regulatory framework established by the Natural Gas Act. To the contrary legislative enactments of Congress subsequent to the passage of the Natural Gas Act have maintained the regulatory dichotomy first established under the Natural Gas Act between production activities and sales.

Thus, with respect to the offshore Federal domain, Congress, under the Outer Continental Shelf Lands Act,[27] first placed the regulation of offshore production in the hands of the Department of Interior, not the Commission. Interior has discharged this statutory responsibility through the United States Geological Survey and has adopted regulations covering in detail every aspect of production from offshore Federal domain acreage.[28] Those regulations provide, in essence, that the operator of an offshore lease must conduct operations as a prudent operator. 30 C.F.R. § 250.33(d).

With the enactment in December, 1975 of the Energy Policy and Conservation Act, Congress once again made its determination that the regulation of development and production of gas reserves is a matter for the Depart-

[26] This appears to be the major thrust of CEC's brief, *i.e.*, that the current administration of the "prudent operator standard" is not consistent with their concept of the "public interest". Necessarily, in light of the bifurcated system envisioned and created by Congress in enacting the Natural Gas Act, such an argument is a legislative one more appropriately addressed to the legislative body which created the existing system – the United States Congress.

[27] 43 U.S.C. § § 1331-1343.

[28] 30 C.F.R. § § 250.1, *et seq*. Production from federal lands onshore is governed by the Federal Mineral Leasing Act, 30 U.S.C. § 181, *et seq*. (1971).

ment of the Interior and the states. Section 106 of the Act[29] deals with the precise area into which the Commission has intruded under Order 539-B. Section 106 provides that Interior shall determine the maximum efficient rate of production from fields containing gas reserves located on federal lands. The maximum efficient rate is that rate which can be sustained without loss of ultimate recovery of gas "under sound engineering and economic principles".[30] Under Section 106(a)(2)(A), the President may require gas production from Federal lands at the maximum efficient rate established by Interior.

The Energy Policy and Conservation Act also deals with gas production from non-federal lands. Just as it was in the Natural Gas Act, jurisdiction over such production was reserved to the states. Under Section 106(b)(1) of the EPCA, the determination of a maximum efficient rate of production from non-federal lands is reserved to the discretion of the appropriate state regulatory bodies.

Finally, in the Department of Energy Organization Act Congress once again dealt with the regulatory structure relating to production from Federal lands. In that Act, Congress transferred some of the Secretary of Interior's functions relating to the production rate and diligence requirements on Federal leases to the Secretary of Energy.[31]

Production activity is, therefore, fully regulated. Indeed, the Commission recognizes the existence of regulatory authority in other regulatory bodies, both state and federal, and even suggests that Order No. 539-B will not impose any regulatory standard different than that which

[29] 42 U.S.C. § 6214.

[30] 42 U.S.C. § 6214(e)(1).

[31] 42 U.S.C. § 7152(b).

is already in existence (Comm. Br. at 32). Thus, the Commission's true position is not that there is a regulatory gap in which there is no regulation of production activities. Rather, the Commission's true position is that there can be no effective regulation of production activities unless the Commission administers that regulation. This presumptive overreaching and intrusion into the authority of other regulatory bodies by administrative fiat must be rejected. There is no regulatory gap resulting from the Section 1(b) production exemption. Instead, regulation of production is being accomplished precisely as Congress intended.

F. The Commission May Not Extend Its Jurisdiction by Asserting That Its Actions Are in the Public Interest.

The Commission's underlying theme throughout this proceeding, and one echoed by CEC, is that production activities of producers must be controlled to protect the "public interest." However, the "public interest" does not serve as some totem determining the limits, or the propriety of extension, of Commission jurisdiction. Rather, as stated in *Mobil Oil Corporation* v. *FPC:*

> The FPC is to be commended for attempting to further that objective, but it is not a sufficient justification upon which to base an expansion of the [Natural Gas] Act to activities clearly not within its terms. Congress did not give the FPC carte blanche to take whatever action it might consider appropriate in furtherance of this purpose. The FPC is limited by the provision establishing its jurisdiction . . . .[32]

[32] 463 F.2d 256, 263 (D.C. Cir.), *cert. denied*, 406 U.S. 976 (1972).

II.

THE IMPACT OF THE NATURAL GAS POLICY ACT OF 1978

The Natural Gas Policy Act of 1978 (NGPA)[33] was signed into law on November 9, 1978. That Act alters to a significant degree the Commission's jurisdiction under the Natural Gas Act. As the Commission correctly points out in its Brief (Comm. Br. at 16), however, most of the gas that was flowing in interstate commerce on November 8, 1978 remains subject to the Commission's regulatory authority under the Natural Gas Act. We therefore agree with the Commission that this case remains one of extreme significance.

The Commission is also correct in pointing out that, as a result of the NGPA, certain sales in interstate commerce for resale will not be subject to regulation under the Natural Gas Act. Specifically, most sales in interstate commerce for resale commenced on or after the NGPA's date of enactment (November 9, 1978) will not be subject to such regulation. NGPA, § 601(a)(1)(A). In addition, certain gas which was committed to interstate commerce as of November 8, 1978, including new natural gas as defined in the NGPA, will no longer be subject to such regulation. NGPA, § 601(a)(1)(B). Of interest so far as this case is concerned is the method by which Congress removed such gas from the coverage of the Natural Gas Act. Congress accomplished that objective simply by removing such gas from the coverage of Section 1(b) of the Natural Gas Act. Reference to Section 1(b) alone was sufficient because, as we have shown, Section 1(b) is the only source of the Commission's jurisdiction under the Natural Gas Act.

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[33] Pub. L. No. 95-621, 92 Stat 3352 (1978).

While we generally agree with the Commission that this case remains a significant one, we disagree with the Commission's assertions as to the NGPA in three particulars.

First, the Commission implies that all future sales from reserves committed to interstate commerce as of November 8, 1978 remain subject to Natural Gas Act jurisdiction. In fact, under Section 601(a)(1)(B) of the NGPA, new gas, certain high-cost gas, and gas from new onshore production wells[34] is no longer subject to such jurisdiction even if it was committed to interstate commerce as of November 8, 1978.

In addition, the Commission is in error when it suggests that the provision of Order 539-B requiring the imposition of the prudent operator standard in future certificates will have no effect after November 8, 1978. Gas from the offshore Federal domain is included within the definition of "committed or dedicated to interstate commerce" for purposes of the NGPA regardless of whether it was contracted to an interstate purchaser prior to November 8. NGPA § 2(18)(A)(i). Therefore, offshore Federal domain gas is removed from regulation under the Natural Gas Act only if it falls within one of the categories specified in Section 601(a)(1)(B). Consequently, if offshore Federal domain gas which is not either new gas or high-cost gas has not yet been certificated, a certificate under the Natural Gas Act will be required. Therefore, the requirement of Order No. 539-B that all future certificates contain a production condition has not been rendered moot by the NGPA.

Finally, the Commission and CEC contend that Order No. 539-B is necessary to avoid the diversion of natural

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[34] New gas is defined in Section 102(c), high-cost gas is defined in Section 107(c)(1)(2)(3) and (4), and new onshore production well is defined in Section 103(c) of the NPGA.

gas committed or dedicated to interstate commerce under the Natural Gas Act into higher priced or deregulated categories under the NGPA. In fact, the NGPA eliminates this concern by empowering the Commission to review all determinations allowing gas from any new well to qualify for a higher maximum lawful price under a particular provision of the NGPA.[35] No distinction, for purposes of the NGPA, is drawn between gas flowing in interstate commerce and gas flowing in intrastate commerce; both are covered. Therefore, the Commission will be able to police any attempted diversion without resorting to any "prudent operator standard" or any other assertion of jurisdiction over production activities.

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[35] § 503(b), 92 Stat. 3396.

CONCLUSION

In sum, this Court has repeatedly found that the provision establishing the Commission's jurisdiction under the Natural Gas Act — Section 1(b) — specifically denies the Commission jurisdiction over production activities. The Court of Appeals, following the mandate of this Court in those decisions, properly determined that since Order No. 539-B concededly attempted to regulate production activities, the Commission had exceeded the limits of its jurisdiction in issuing that Order. Therefore, the decision of the Court of Appeals vacating Order No. 539-B should be affirmed.

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CERTIFICATE OF SERVICE

I hereby certify that I have served this Brief on all parties on December 22, 1978, in accordance with the rules.

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FOR ARGUMENT

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Nos. 77-1652 and 77-1654

In the Supreme Court of the United States

OCTOBER TERM, 1978

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

SHELL OIL COMPANY, ET AL.

CONSUMER ENERGY COUNCIL OF AMERICA, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION AS PETITIONER IN NO. 77-1652

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Washington, D.C. 20530

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The argument of the respondent producers is based on the proposition that Section 1(b) of the Natural Gas Act grants jurisdiction to the Commission over the sale of only so much dedicated gas as the certificated producer chooses to produce (Shell Br. 22; Tenneco Br. 15).[1] On

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[1] *E.g.*: "The Commission's authority to insure that gas which is produced is *sold* in interstate commerce most assuredly does not carry with it the authority to compel or regulate the rate of production of that gas." Tenneco Br. 15 (emphasis in original).

this theory, if production is reduced or terminated by the producer willfully or negligently, where the supply of dedicated gas is not depleted, the Commission has no power to restore delivery service by invoking its authority under Section 7(b) to regulate abandonment or its authority under Section 4(d) to regulate changes in service.

This contention would effectively nullify the concept of dedication of producer reserves to interstate commerce that has been developed by this Court since it held in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), that the Natural Gas Act applies to independent producers. See, *e.g.*, *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 156 (1960); *California* v. *Southland Royalty Co.*, 436 U.S. 519 (1978). The dedication concept is based on the producers' obligation to maintain the certificated service of delivering gas to interstate commerce and on the Commission's authority to enforce that obligation under the Act.

The respondent producers and the amici supporting them fail to confront the central legal issue in this case, which may be illustrated by a simple hypothetical. Suppose that a producer, having obtained a certificate from the Commission authorizing interstate sales from specified gas reserves, fails (for whatever reason) to undertake the most elementary maintenance of its production facilities, so that they fall into disrepair with the result that production, and hence deliveries, cease. The issue is whether the Commission has authority under the Natural Gas Act to do anything about it.

The Commission contends that it does; indeed, that it must take action in such a situation if the service obligation established by *Sunray*, *supra*, and other cases (see our main brief at 20-22) is to have any meaning. The court of appeals held that the Commission has no such authority. The respondent producers avoid the question.

They argue at length that the mechanics of gas production are complicated, that producers have little or no incentive to curtail production, and that the states already adequately regulate the production of natural gas.[2] All of these factual contentions may be assumed for the sake of argument. The legal question remains whether the Commission has the power under the Natural Gas Act to enforce delivery obligations in those cases (whether few or many) where unreasonable operation results in the cessation of production and delivery.

We have argued in our main brief (pages 23-30) that the Commission has that power under the Act as interpreted in this Court's decisions, and that the production or gathering exclusion of Section 1(b) of the Act does not deprive it of that power.

Respondents misread the history and purpose of the production or gathering exclusion in Section 1(b). That provision's purpose, as this Court has held (*e.g.*, *Phillips Petroleum Co.* v. *Wisconsin*, *supra*, 347 U.S. at 679), was not to limit the jurisdiction granted affirmatively to the Commission by Section 1(b)—jurisdiction that necessarily includes power under Section 7(b) and Section 4(d) to assure delivery of dedicated gas while the supply lasts. Its purpose was to confirm that the states' jurisdiction over conservation and health and safety was not to be curtailed by the federal regulation (see our main brief at pages 24-30). The states, however, have no constitutional authority or responsibility to regulate interstate delivery; that is why the Natural Gas Act was adopted. *Interstate Natural Gas Co.* v. *FPC*, 331 U.S. 682, 689-693 (1947). Consequently, the states do not require maintenance of production in aid

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[2]See Shell Br. 3-5, 28-31; Tenneco Br. 15, 19-20.

of interstate delivery obligations.[3] The proposition advanced by the producers and adopted by the court of appeals would open a gap between the regulation by the states and the regulation of interstate delivery obligations permitted to the Commission under the Act.

The producers advance a number of contentions that are speculative and not ripe for review at this time. *Shell et al.* contend, for example, that the incorporation of a prudent operator standard into the producers' delivery obligations will result in conflict with state conservation requirements or in unrealistic production demands (Br. 28-29). There is no basis for that prediction; as we noted in our main brief (pages 31-33), the Commission stated that its prudent operator standard encompasses the obligations imposed by valid state regulatory standards and is to be administered with reference to those standards (Pet. App. 20a).[4] It cannot be assumed, therefore, that the Commission will require producers to drill wells in violation of state conservation standards.

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[3]Similarly, neither the Outer Continental Shelf Lands Act, 43 U.S.C. 1331 *et seq.*, nor the Energy Policy and Conservation Act, 42 U.S.C. 6214, confers authority on the Department of the Interior to enforce certificated delivery obligations under the Natural Gas Act.

[4]State conservation laws and orders may be invalid under the Due Process, Commerce, or Supremacy Clauses of the Constitution if they: (1) have no reasonable relation to the prevention of waste or the protection of correlative rights, *Thompson* v. *Consolidated Gas Utility Corp.*, 300 U.S. 55, 59-70 (1937); (2) operate as a partial or total embargo against the interstate sale and delivery of gas, *Pennsylvania* v. *West Virginia*, 262 U.S. 553 (1923); *Oklahoma* v. *Kansas Natural Gas Co.*, 221 U.S. 229 (1911); (3) establish maximum or minimum prices for interstate sales of natural gas, *FPC* v. *Corporation Commission of State of Oklahoma*, 362 F. Supp. 522 (D. Okla. 1973) (3-judge court), affirmed, 415 U.S. 961 (1974); (4) cause withdrawal of a large volume of gas from the established interstate current of gas, *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 632-633 (1972); or (5) indirectly regulate purchase prices by pipelines or the volumes that pipelines may take from producers for interstate delivery, *Northern Natural Gas Co.* v. *State Corporation Commission of Kansas*, 372 U.S. 84 (1963).

Indeed, any assumptions about what the prudent operator standard as administered by the Commission may require in particular cases, such as Shell's prediction that the Commission will say that a producer "must drill wells and install additional production equipment to maintain the deliverability of his wells" (Br. 24; see also *id.* at 14), are speculative. All that is at issue in this rulemaking proceeding is the Commission's statutory authority to adopt and enforce a standard defining the delivery obligations of producers under the Act.[5]

For the foregoing reasons and the reasons stated in our main brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

JANUARY 1979

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[5]That standard is not, as *Shell et al.* contend (Br. 31-32), an invalid retroactive limitation on existing certificates. It simply gives content to the delivery obligation that those certificates imply. See the Commission's opinion at Pet. App. 21a.

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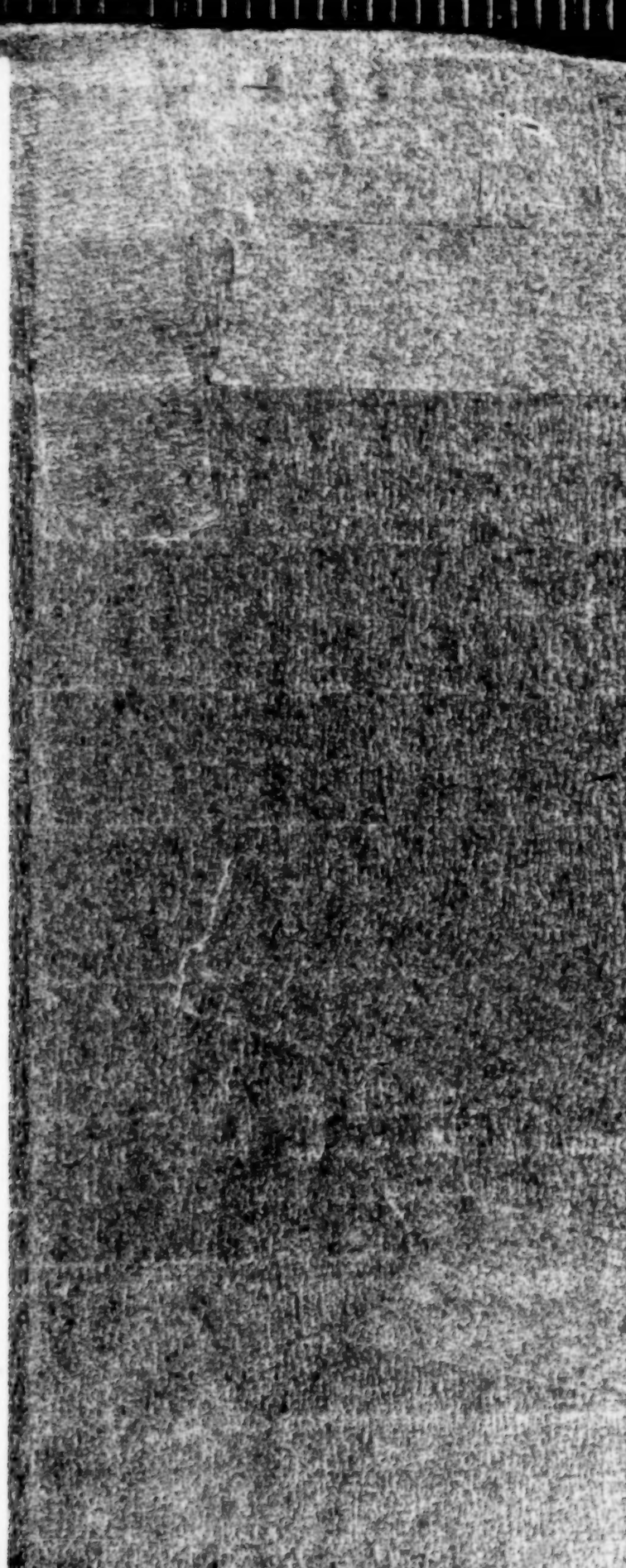


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MISCELLANEOUS:

Brief for the Federal Energy Regulatory Commission in No. 77-1652 and 77-1654 . . . . . 7, 11, 20

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x

Memorandum for the Federal
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 77-1652

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

SHELL OIL CO., ET AL.,
Respondents.

No. 77-1654

CONSUMER ENERGY COUNCIL OF AMERICA,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF OF PETITIONER CONSUMER ENERGY COUNCIL OF AMERICA

In response to the challenge of Consumer Energy Council of America ("Council") to Order 539-B's prudent operator standard, the Federal Energy Regulatory Commission ("Commission") does not dis-

pute our claim that the Natural Gas Act ("Act"), on its face and as interpreted by this Court, is centrally concerned with the maintenance of steady and reliable service. Nevertheless, the Commission fails to explain how the prudent operator standard in fact reflects the Act's service concern or, indeed, why this standard never looks to past service in giving substance to the producers' obligations. Nor does the Commission seek to justify Order 539-B's failure to draw upon the express provisions of § 4(d) or § 7(b) of the Act, 15 U.S.C. § 717c(d) and § 717f(b), pursuant to which the burden is on the producer to explain and obtain approval for reductions in service. */

Rather, the Commission defends its position along essentially three lines. First, it claims in conclusory fashion that Order 539-B is due great deference by this Court, and is thus essentially beyond challenge by the Council. Second, it finds support for the reasonableness of its position in the fact that it has now tied the prudent operator standard directly to the laws of the applicable producing state. And third, it criticizes the Council for not being more specific

*/ Cf. Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. 137, 141, 156, (1960). Reliance on such procedures was also a central element of the Commission's initial Order 539. R. 147-58.

in articulating a proper standard governing service. */ As indicated below, principles of deference do not place Order 539-B beyond challenge; the Commission's effort to avoid conflict with state law by incorporating it wholesale further undercuts the standard's validity; and, finally, little effort is needed to flesh out the service concept the Council advances.

*/ The Commission also suggests that the Council's challenge to the prudent operator standard is not appropriate for judicial consideration at this time, since that issue was not ruled on by the Court of Appeals. We assume that the Court has, by granting certiorari, already provided its own answer to this suggestion. In any event, sound reason resides in review disposing of this entire litigation, because (1) a substantial period of time has already been consumed on appeal; (2) the Commission's efforts in this area will continue to be in a state of limbo until final resolution of all the issues; (3) the terms of the Natural Gas Policy Act of 1978 (Pub. L. No. 95-621)("NGPA") make prompt resolution all the more important (see Brief of Petitioner Consumer Energy Council of America ("Council Brief") at 18-23); and (4) the question is one purely of law, and has been fully briefed in this Court. See Permian Basin Area Rate Cases, 390 U.S. 747, 823-24 (1968); see also New Motor Vehicle Board v. Orrin

(footnote continued)

For their part, the producers properly pose the issue: whether the Commission or the producer is the appropriate party to assess the reasonableness of declining deliveries. But they propose the wrong answer. In the process, they attempt to read producer service jurisdiction out of the Act altogether. They also seek to bolster their contentions by mischaracterizing the Council's position, which does not argue for a warranty arrangement ignoring the technical and geological reality in the field, but simply seeks a mechanism assuring Commission oversight and approval of declining deliveries. Finally, the producers raise the specter of Commission orders directing "the producer as to how, when and where his capital is to be invested to produce the gas reservoir most efficiently." Brief of Respondent Producers ("Shell Brief") at 14. Whatever might be contemplated by the Commission's prudent operator standard, this would not be the case under an appropriate service standard. That is not to say, however, that producers can avoid their obligations under the Act by merely asserting that expenditures may have to be made in order to meet their service obligations.

(footnote continued)
W. Fox Co., 47 U.S.L.W. 4017, 4021 n. 13 (Dec. 5, 1978); FPC v. Sunray DX Oil Co., 391 U.S. 9, 45-46 n. 35 (1968).

I. THE PRUDENT OPERATOR STANDARD CANNOT WITHSTAND APPROPRIATE REVIEW

A. The Commission's Prudent Operator Standard Is Not Due Substantial Deference

The Commission contends that, because it is the agency charged with enforcing the provisions of the Natural Gas Act, its interpretation of producer delivery obligations is essentially beyond challenge. Memorandum for the Federal Energy Regulatory Commission as Respondent ("FERC Mem.") at 4-6. In short, the Commission asks for blind acceptance of the standard, without supplying any explanation of why the formulation is a reasonable one. Moreover, the Commission seeks this protected status for Order 539-B without so much as hinting why the Order should obtain more favored review from the Court than any other order under the Natural Gas Act. In the process, the Commission provides both an incomplete and misleading characterization of the Court's decisions relating to the degree of deference accorded an administrative agency's construction of statutory terms.

This Court has held that an order of the Commission, to be upheld, must fall within a "zone of reasonableness." Permian Basin Area Rate Cases, 390 U.S. at 767. To satisfy this standard, three distinct tests must be met. The order

must be: (1) consistent with statutory authority; (2) supported by substantial evidence; */ and (3) reflective of a proper balance between the interests of the industry and consumers.**/ Id. at 791-92. In conducting this examination, however, the scope of review and the deference to be shown the agency's decision will vary substantially depending upon the particular test involved. Thus, under the second -- substantial evidence -- test, special deference may be due to "legislative" or "policy" rules. See 1 K. Davis, Administrative Law Treatise, §§ 5.03, 5.05-5.07 (1958). However, under the first -- statutory

*/ Permian Basin, and rate cases generally, represent the prototypical deference situation. There, a reviewing court is faced with an agency long-experienced in the rate-setting process, analyzing a host of concrete factual factors, in formulating a forward-looking policy determination. As indicated below, this is not the situation presented here.

**/ By relying on a concept which so heavily reflects producer profitability, the Commission also fails to strike the proper balance under the third test. See discussion at pp. 12-15, infra.

interpretation -- test, the scope of review is much stricter. This Court has said repeatedly that "the interpretation of the meaning of statutes . . . is exclusively a judicial function," United States v. American Trucking Associations, 310 U.S. 534, 544 (1940), in which the court retains the final word as to the propriety of the administrative construction. See SEC v. Sloan, 436 U.S. 103, 117-18 (1978); Batterton v. Francis, 432 U.S. 416, 424 and 425-6 n. 9 (1977); NLRB v. Enterprises Association of Pipefitters Local 638, 429 U.S. 507, 522 n. 9 (1977). */

The Commission itself has characterized Order 539-B as an exercise in statutory interpretation, **/ and cor-

*/ The Commission has relied on Niagara Mohawk Power Corp. v. FPC, 379 F.2d 153 (D.C. Cir. 1967) and FCC v. National Citizens Committee for Broadcasting, 436 U.S. 775 (1978), among others, to bolster its claim of deference. FERC Mem. at 4-6. However, in so doing, the Commission has confused the respective scopes of review under the first and second test of the zone of reasonableness standard. The cases cited refer to the deference due a "legislative" or "policy" judgment of the agency, and are of minimal relevance to issues of statutory interpretation.

**/ Brief for the Federal Energy Regulatory Commission ("FERC Initial Brief") at 34; FERC Mem. at 4.

rectly so. Thus, a more searching scope of review should be applied, involving an independent determination of whether the Commission's construction is consistent with the language, legislative history and purpose of the Natural Gas Act. See SEC v. Sloan, 436 U.S. 103; United States v. Larionoff, 431 U.S. 864, 873 n. 12 (1977); see also FPC v. Texaco, Inc., 417 U.S. 380 (1974); Morton v. Ruiz, 415 U.S. 199 (1974).

By the above analysis, we do not mean to suggest that no deference may be paid an agency's interpretation of its statute. But even the more modest deference given statutory interpretation depends upon the presence of certain factors. Batterton v. Francis, 432 U.S. at 425-26 n. 9; Skidmore v. Swift & Co., 323 U.S. 132, 139-40 (1944); Davis, supra § 5.11. Primarily, deference may be shown when administrative interpretations are longstanding, consistent, or draw upon special experience. See Red Lion Broadcasting Co. v. FCC, 395 U.S. 367, 381-82 (1968); United States v. Healey, 160 U.S. 136, 145 (1895). But see Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672, 677-78 (1954), where this Court declined to adopt the Commission's interpretation of the Natural Gas Act, as it related to producers; and SEC v. Sloan, 436 U.S. at 117-19.

Order 539-B, however, represents the Commission's first effort to interpret the extent of producer delivery obligations, in a changed supply situation of recent origin. This may explain

why, since the development of the standard was initially undertaken, the form has twice changed radically -- from Order 539 to 539-A, to 539-B. In any event, the interpretation cannot be termed either consistent or longstanding. Also, it should be noted that, at the time of the proceedings in question, a number of the Commissioners were newcomers to the agency, and had little experience in natural gas regulation. */ In addition, most of the more experienced members of the Commission's staff in this area had been recently transferred and replaced with inexperienced personnel. **/ Taken together, these factors demonstrate that the Commission did not possess a "more specialized experience . . . than is likely to come to a judge in a particular case." Skidmore v. Swift & Co., 323 U.S. at 139. Finally, Order 539-B fails to demonstrate the thoroughness of analysis and reasoning which could entitle it to particular deference. In formulating the prudent operator standard, the Commission simply adopted state law concepts because of their familiar-

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*/ Subcomm. on Oversight and Investigations of the Comm. on Interstate and Foreign Commerce, 95th Cong., 1st Sess., Report on Adverse Personnel Actions Against Professional Staff Members at the Federal Power Commission at 2 (Comm. Print 1977).

**/ Id. at 13.

ity to producers, not because, through application of its accumulated expertise, it had developed a finely tailored approach to give form to the Act's service obligations. Council Brief at 42-43.

B. The Prudent Operator Standard Is In Conflict With The Provisions Of The Act Designed To Assure Reliable Service

As indicated above, the basic dispute between the Council and the Commission concerns the proper interpretation of the Natural Gas Act. We do not argue, as the Commission states (FERC Mem. at 3), that the Act might be more effectively implemented through a somewhat different rule; rather, we contend that the prudent operator standard is fundamentally at odds with the Natural Gas Act, which was intended to assure that service be continued unless and until the Commission should find a change or abandonment of service to be in the public interest. */

We showed in our initial brief that the Commission's standard, drawn from state law, could not be relied upon to provide consumers of dedicated gas reliable service. In trying to ward off the producers' contention that the federal standard will conflict with state regulation, the Commission has "clarified" its position by stating that the federal standard will not just be drawn from

*/ We also argue the standard is vague and unenforceable. Council Brief at 43-50.

state law, but will indeed be identical to state law. */ But if the various state laws which the Commission, in a leap of blind faith, embraces as the federal standard on any occasion further the ends of the Act, it will be by coincidence only. Moreover, the adoption of these laws violates a cardinal principle underlying the Act, which was designed to establish a comprehensive federal regulatory scheme in place of a patchwork of state regulations.

1. Conservation Law. As indicated in our initial brief, laws relating to conservation cannot provide the basis for an adequate service standard. The simple reason for this is that conservation laws are aimed at preventing waste, and there is no need to assure minimum production or service levels in order to achieve that end. Council Brief at 41. **/

*/ The Commission states that its standard will not impose obligations different than those under state law, but will simply require "that the producer operate in accordance with established practice and with requirements adopted by the jurisdiction exercising direct regulation over the production." FERC Initial Brief at 32. (Emphasis added.)

**/ This fact has a direct bearing on the producers' claim that jurisdiction is precluded because there is no regulatory gap. See e.g., Brief of Respondent Tenneco Oil Company and Pennzoil Company ("Tenneco/Pennzoil Brief") at 19-23.

Moreover, while we, no less than the Commission and the producers, fully support state conservation principles, it is neither necessary nor appropriate to use state conservation laws as the federal standard in order to avoid conflict. The Commission's regulations dealing with abandonment already accommodate state conservation standards, */ as does the Commission's definition of deliverability, quoted in our original brief (Council Brief at 15-16 n. 19). In the same manner, a proper service standard, although independent of state conservation laws, could be expected to take those laws into consideration.

2. The Law Governing The Producers' Lease. The validity of the prudent operator standard, then, must ultimately be determined by reference to the laws governing the producer's lease. However, as demonstrated in our initial brief, that body of law is infused with considerations of profitability, **/ and is

*/ The Commission's regulations dealing with abandonment provide that "nothing herein shall be construed as interfering or as intended to interfere with or to prevent compliance by a natural-gas company with valid conservation orders of a State agency relating to the production or gathering of natural gas." 18 C.F.R. § 157.30(a)

**/ See e.g., E. Brown, Law of Oil and Gas Leases, § 16.05 at 16-151 (2d ed.
(footnote continued)

thus ill-suited to achieving the purposes of the Act. Council Brief at 39-41. The Commission has not shown otherwise. */ The producers, however, contend that under their leases they must produce gas expeditiously because "(i) other lessees on adjoining leases in the same reservoir will deplete the reservoir from their wells; (ii) the lessor will insist on speedy and maximum production," in order to protect his interests. Shell Brief at 26. The

(footnote continued)
1973): "[T]here have been hundreds of decisions from the courts in practically all of the oil and gas producing states affirming and adopting the principles, as stated in the Brewster case [Brewster v. Lanyon Zinc Co., 140 F. 801 (8th Cir. 1905) cited in our initial brief at 39]," [that] '[i]t is only to the end that oil and gas shall be extracted with benefit or profit to both [the lessee and lessor] that reasonable diligence is required . . .'" (quoting from Clifton v. Koontz, 160 Tex. 82, 325 S.W.2d 684, 695-96 (1959)).

*/ Indeed, in a major investigation into off-shore non-producing reserves, an administrative judge of the agency recognized this shortcoming of Order 539-B's prudent operator standard. After alluding to the standard's vagueness as an analytical tool, the judge explained that the standard in private law is designed to further "the private
(footnote continued)

amount of protection the lessor-lesse relationship may provide the interstate consumer is perhaps best illustrated by considering a leading Oklahoma Supreme Court decision on the subject.

In the case of Gazin v. Pan American Petroleum Co., 367 P.2d 1010 (Okla. 1962), cited in H. Williams and C. Meyers, Oil and Gas Law, § 856.3 at 409 (1976), the defendant completed a gas well in 1956 capable of producing in excess of 20 million cubic feet of gas per day, and with an overall potential of approximately 4 billion cubic feet of gas. The well was shut in and no contract for the sale of gas was made until 1960. The court found that there was no drainage of oil or gas from the leased premises. */

(footnote continued)
financial interest of parties to an oil or gas lease," and concluded: "In general, therefore, the Commission's objective [in formulating a standard governing delivery obligations] and the purposes of the common law implied convenant are widely divergent." Initial Decision of Presiding Administrative Law Judge on Investigation of Offshore Dedicated Natural Gas Reserves in the Federal Domain in the Gulf of Mexico, FERC Docket No. RI75-112 at 95 (July 7, 1978).

*/ Drainage only occurs if a different lessee on adjoining premises drills a well into the same reservoir and begins to withdraw gas in excess of his allowable share.

The court also found that the lessee had exercised reasonable diligence in seeking and obtaining a satisfactory market, and that therefore there was no breach of any implied covenant. The court so found despite the fact that the lessee could have sold the gas to a nearby pipeline long before 1960. The lessee had refused to sell the gas in the hope of exacting more favorable contract terms from the pipeline, a hope which was realized at the end of the four year wait.

Similarly, it is clear that the prudent operator standard would not be violated if the producers delayed production in order to secure a more favorable rate for dedicated gas. The same result would obtain if the gas could be diverted for sale at a deregulated price. */ In either case, the ultimate increase in profits would be to the mutual advantage of the lessor and lessee.

*/ The producers have asserted that the Natural Gas Policy Act (NGPA) creates no incentive to shift production from dedicated wells to new wells, because such a shift is physically impossible. Shell Brief at 27 n. 34. The reasons the producers give to support this argument are overly simplistic. For example, the producers claim that state well-spacing requirements will prevent a physical shift

3. The Concept of Reliance on State Law. The Commission's action in drawing the product operator standard

(footnote continued)
from one well to another. Assuming arguendo that this proposition is correct in theory, for a variety of reasons exceptions can be granted to well-spacing requirements. Cases have been found in which the majority of all wells in a field were drilled as a result of "exceptions." 1 M. Myers, The Law of Pooling and Unitization, § 1.01 at 17 (1967). However, a producer would only need to obtain one such exception in order to drain the entire supply of gas from a geologically simple reservoir. See Excerpts from the Report of the Governors' Special Study Committee on the Interstate Oil Compact Concerning the State Conservation Laws, reproduced in 5 W. Summers, Oil and Gas § 1053 at 270 (1966).

Producers also assert that the Commission's power to review state agency determinations allowing gas to qualify for a higher price under the NGPA is adequate to assure that already dedicated gas will not be diverted into higher priced or deregulated categories. Tenneco/Pennzoil Brief at 25-26. This is simply incorrect. While the Commission clearly has authority to assure itself that allegedly new gas actually meets the requirements of NGPA, nothing (footnote continued)

firmly into the orbit of state law also conflicts with a fundamental principle of the Natural Gas Act, i.e. that there be a comprehensive and uniform regulatory scheme. FPC v. Transcontinental Gas Pipe Line Co., 365 U.S. 1, 27-28 (1961). See also California v. Southland Royalty Co., 98 S. Ct. 1955, 1961-62 (1978); FPC v. Louisiana Power & Light Co., 406 U.S. 621, 631, 633-35 (1972); Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672, 691 (1954). A standard such as "prudent operation," which will vary from state to state, */ depending on concepts of local property law and state regulatory practices, will inevitably produce a checkerboard of federal regulation which the Act, as interpreted by this Court, was designed to prevent.

(footnote continued)
therein either allows or requires the Commission to determine that service from old wells is being maintained as a prerequisite to granting new gas status. For example, as long as the new well is the required 2.5 miles distant from, or 1,000 feet deeper than the old well, gas produced from the new well would qualify for the higher price, regardless of whether production from the old well had been curtailed. NGPA § 102(c)(1)(B).

*/ See e.g., Excerpts from the Report of the Governors' Special Study Committee, supra, reproduced in 5 W. Summers, Oil and Gas, § 1053 at 319-400, which provides a comparison of producing state laws.

Finally, there is a contradiction in the Commission's own reasoning. If, as the Commission and Council agree, there is a present need for the Commission to spell out the nature and extent of producer delivery obligations under the Act so as to provide the consumer assured and reliable service, it follows that the need has not been met by already existing state production standards.

C. The Contours Of A Service Standard Are Readily Apparent

The Commission is dissatisfied that we have not formulated a more precise standard for the agency's use. FERC Mem. at 9. This suggestion that we dictate an exact standard to the agency is hardly in keeping with the Commission's repeated claim that deference should be paid to its accumulated expertise. Id. at 4-6. Nevertheless, we have already suggested the contours of a standard consistent with the Act. See Council Brief at 48-49. The goal is clear: to require producers to justify declines from past service. For administrative ease, the Commission might want to utilize a profile drawn to reflect the production over time of a typical field, with leeway built in to provide for automatic approval of declines within a certain range of the norm. See related discussion of producer obligations at pp. 27-29, infra. Within these broad parameters, it is the Commission, not the consumer that should give real content

to a rule governing declining service. */ Our legal argument is not premised on a contention that the Council is able to develop a better mechanism than the Commission could. Our argumemt is that the Commission's standard is contrary to the law. That contention stands on its own merits.

II. THE PRODUCERS FAIL TO OFFER VALID OBJECTIONS TO PROPER REGULATION OF SERVICE OBLIGATIONS

A. The Producer Challenge To Commission Jurisdiction Seeks To Rewrite The Natural Gas Act

On the threshhold jurisdictional question, the producers seek to ignore both the purpose and the express terms of the Act. Shell has essentially asserted that no delivery standard would be jurisdictional, since implementation would involve the Commission, at least incidentally, in some aspect of production activity. Shell Brief at 21. Tenneco and Pennzoil somewhat more generously acknowledge that the Commission "has full authority to compel producers to sell in interstate commerce gas which is produced from dedicated acreage." Tenneco/Pennzoil Brief at 15.

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*/ In performing this task, the Commission may find valuable assistance in the analysis provided by Amici Curiae United States Council of Mayors, et al. in their brief in this proceeding.

However, they maintain that no jurisdiction attaches to service obligations if the producer chooses not to produce at all. Id. */

We believe these points have been adequately anticipated in our brief and that of the Commission. Council Brief at 50-59; FERC Brief at 23-30. Now that the producers' exact positions have been made clear, however, two comments seem appropriate. First, the producers' reading would necessarily render the carefully crafted abandonment provisions of § 7(b) of the Act a nullity. Under their view, the Commission would have no recourse if it denied a producer's request to abandon, but the producer nevertheless chose to close down production. A Commission order thereafter seeking to enforce the denial of abandonment would, by their reading, be beyond the Commission's jurisdiction.

But the basic problem with the producers' jurisdictional argument is that it ignores the purpose of the Act, and the purpose of the exemption. We fully agree with the Commission that a reasoned interpretation of § 1(b) cannot be so "mechanistic," but must reflect a functional approach FERC Initial Brief at 29. In determining the scope of

*/ For support, the producers rely almost exclusively on pre-Phillips decisions, and of course, no decisions which deal with service and supply under the Act.

federal authority over pipelines in Illinois Gas Co. v. Central Illinois Public Service Co., 314 U.S. 498 (1942), this Court rejected just such a "mechanistic" formulation. In that case, the Court stated: "[T]he Court, in determining the validity of state regulations, has been less concerned to find a point in time and space" where federal authority ends and state authority begins, "and has looked to the nature of the state regulation involved, the objective of the state, and the effect of the regulation upon the national interest. . . ." Id. at 505.

A similar approach was followed in United Gas Pipe Line Co. v. FPC, 385 U.S. 83, 89-90 (1966), where the Commission's authority to require a pipeline to purchase natural gas in order to end a de facto abandonment was upheld, despite the absence of a specific statutory provision governing these pipeline purchases. The Court reasoned that pipeline purchases are incidental to transportation and sale which are within the Commission's authority to regulate, and that the pipelines' failure to purchase so as to continue certificated transportation and sale was clearly subject to regulation under the Act. */

*/ Needless to say, regulation of service does not render the production and gathering exemption a nullity. See Shell Brief at 16. State Commissions will
(footnote continued)

B. Under A Service Standard, Costs May Be Taken Into Account, But Profitability To The Producer Cannot Be The Sole Measure Of The Obligation

Beyond the strict legal question of jurisdiction stands the fundamental issue posed by the producers -- whether under the Natural Gas Act, they or the Commission should decide if declines in deliveries, and the resultant impact upon the relying consumer, are justified. Shell Brief at 33. We maintain that the terms, purpose and scheme of the Act lead inexorably to the conclusion that this is a task ultimately committed to the Commission.

In opposing federal regulation of service, the producers advance a number of economic arguments. First, the producers argue at length that the shortage of gas which has plagued the nation throughout much of this decade resulted from the low rates ordered by the Commission. In effect, the producers repeat to this Court the argu-

(footnote continued)
continue to regulate as before. There is no reason to anticipate any conflict between federal and state requirements. If such a conflict should, however, for some reason materialize, it can be dealt with on its specific facts. Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. at 157.

ments they made to Congress in favor of deregulation. The battle over deregulation of new gas, however, is over, and little can be gained by reviewing it. The question here involves old gas, already dedicated to interstate commerce under the Natural Gas Act. Congress chose not to deregulate this category of gas. Moreover, in the NGPA Congress largely preserved the Commission's prior rates with respect to dedicated gas. NGPA § 104(b). The legislature apparently did not agree with the producers that those rates were inadequate. Furthermore, Congress made it clear that consumers should continue to receive this vast quantity of old gas at the rates which were thus preserved. See Council Brief at 18-23.

The producers nevertheless think that regulated rates may prove too low to warrant maintenance of service. However, if these rates are too low, relief is available. The Commission can allow a price higher than the prescribed rate, if it finds a higher price would be just and reasonable within the meaning of the Natural Gas Act. NGPA § 104(b)(2). Alternatively, the Commission could allow a change in service under § 4(d) of the Natural Gas Act, if it found that maintenance of service was not appropriate. Our contention is not that service must be maintained regardless of cost. Our contention is only that the Commission, not the producers must have the final word

as to whether the expense is too great to warrant maintenance of service. Indeed, it is worth noting that every time the Commission grants or denies abandonment of service under § 7(b), it does just that. */ We seek no alteration in these procedures or principles.

To say, however, that costs must be taken into account along with other factors, is not to say that maximization of profit can be the final measure of the supply obligation. See FPC v. Texaco, Inc., 417 U.S. at 398-99. The Commission's duty is to strike a balance between the financial interests of the industry and the needs of the consumer. FPC v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944). The producers ignore this fact. And,

*/ In actual practice, abandonments occur when production is no longer economically feasible, not when the gas is physically depleted. See testimony of the Federal Power Commission in Vol. I, Part 2, of Hearings on the Natural Gas Supply in the United States Before the Subcomm. on Oversight and Investigations of the Comm. on Interstate and Foreign Commerce, 94th Cong., 1st Sess. at 1104 (1975). This Court noted in Permian Basin Area Rate Cases, 390 U.S. at 773, that "only in 'exceptional situations' would the abandonment of unprofitable facilities prove detrimental to consumers, and thus impermissible under § 7(b)."

as discussed above, the prudent operator standard represents no such balance, because ultimate compliance with the standard is determined by reference to what is in the interest of the lessor and lessee.

The producers argue that to maintain service, however, they may have to drill new wells and install new equipment, something they say the Commission cannot order. For support, they claim that the Commission lacks authority to order pipelines to make additional investments, and that to order the producers to do so "expands the Commission's jurisdiction over producers beyond that which it has over pipelines." Shell Brief at 24. Whatever application of the prudent operator standard might require, the service standard advanced by the Council would not contemplate Commission orders directing such investments. Under our standard, as contemplated by § 7(b) and § 4(d) of the Act, the Commission's sole function would be to determine whether a proposed reduction in service was justified by the arguments advanced by the producer.

Nevertheless, in the interest of accuracy, we think it important to note that the Commission very definitely does have authority to order pipelines to make additional investments. See

§ 7(a), 15 U.S.C. § 717f(a). */ Moreover, scores of Supreme Court cases can be found holding that public service corporations, ranging from gas, electric, and telephone companies to railroads, can be required to make capital expenditures necessary "for the rendition of the service to which the [corporation] has committed itself." ICC v. Oregon-Washington Railroad and Navigation Co., 288 U.S. 14, 37 (1932). **/

By focusing heavily on economic questions, the producers have simply highlighted the relationship between price and supply. We fully appreciate the intimate relationship between rates and service, as did Congress in passing the Natural Gas Act. That Act provides for regulation of both, in recognition of the fact that to regulate the one without the other may be an exercise in futility. ***/

*/ The cases cited by the producers (Shell Brief at 24) were decided under a proviso to this section.

**/ In addition to the long list of cases cited in ICC v. Oregon-Washington Railroad and Navigation Co., 288 U.S. at 32 n. 12, see New York ex rel. v. Public Service Commission, 269 U.S. 244 (1925), and New York & Queens Gas Co. v. McCall, 245 U.S. 345 (1917), both dealing with gas companies.

***/ It is noteworthy that the Interstate Commerce Act, as originally passed, (footnote continued)

C. Service Obligations Are Susceptible Of Reasoned Regulation By The Commission

Another theme in the producers' briefs is the contention that gas production is such a mysterious and capricious process that producers' delivery obligations lie beyond the reach of effective regulation. See e.g., Shell Brief at 30. Hence, the producers suggest that the Commission, and consumers who rely upon continued spplies of gas at reasonable rates, must simply trust in the producers.

(footnote continued) provided for regulation of rates alone. Responding to the lower rates which the ICC found to be just and reasonable under the Act, the railroads began substantially to cut back service. To counter the resulting distortion, Congress amended the Act to include a variety of service provisions. This legislation provided the model upon which the Natural Gas Act was closely patterned. For a more thorough discussion of the amendment of the Interstate Commerce Act to include provisions relating to service, see 1 Sharfman, The Interstate Commerce Commission, at 94-103, 177-79, 235-244 (1931).

However, while rates of decline in reservoir production may vary, they are not unpredictable. Thus, in a treatise put out by the Interstate Oil Compact Commission, it is said that:

> "The future performance of wells, tracts, and pools under specified operating conditions may be predicted by a careful analysis of a number of measurements. Forecasts of pressure changes and of the total recoverable oil and gas under different assumed practices can be made with reasonable accuracy. Changes in . . . well productivity, and production rates are quantitatively related to the changes in pressure and are also predictable."

Interstate Oil Compact Commission, Oil and Gas Production at 82 (1969). Moreover, the producers, in providing this Court with a graph of the flow of gas from the typical field, have amply demonstrated that gas production does follow a pattern and thus lends itself to the regulatory oversight we submit the Act requires. Shell Brief at 3.

Finally, regulations can surely be written that take into account a certain range of deviation. The Department of the Interior, in establishing an upper limit on production, has formu-

lated just such a rule. Thus, for example, one order of that department provides: "temporary well production rates resulting from normal variations and fluctuations exceeding a well MPR [maximum production rate] or reservoir MER [maximum efficient rate] shall not be considered a violation of this Order." OCS Order No. 11, May 1, 1974, reproduced in Vol. III of Hearings on the Natural Gas Supply in the United States Before the Subcomm. on Oversight and Investigations of the House Comm. on Interstate and Foreign Commerce, 94th Cong., 2d Sess. at 249 (1976). And, in any event, the Commission is fully capable of determining whether declines in production below the norm are justified for technical or geological reasons.

The essential point, however, is that the questions of service and justification for deviation are matters for the Commission -- not exclusively the producers -- to consider. That is the scheme of the Natural Gas Act, and is central to its basic purpose of protecting the consumer.

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*/ The producers also argue that no delivery obligations can be imposed on them with respect to certificates issued prior to Order 539, because the certificates gave "no hint" of any such obligations. Shell Brief at 31. The short answer to this can be found in Sun Oil Co. v. FPC, 364 U.S. 170 (1960). (footnote continued)

CONCLUSION

In closing, we note that two central themes run through this Court's decisions on the Natural Gas Act. The first theme is the Act's concern for the ultimate consumer, and the need to protect him against unilateral acts of natural gas companies which may frustrate his need for a steady and reliable supply of natural gas. See, e.g., California v. Southland Royalty Co., 98 S. Ct. at 1958; FPC v. Louisiana Power & Light Co., 406 U.S. at 631; Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. at 147; Phillips Petroleum Co. v. Wisconsin, 347 U.S. at 685; FPC v. Hope Natural Gas Co., 320 U.S. at 610. The second theme is a willingness to cut through the conflicting legal arguments and look carefully at the necessary consequences, or practical effects, involved in a proffered reading

(footnote continued)
Whereas in issuing a certificate to Sunray (Sunray Mid-Continent Oil Co., supra) the Commission explicitly stated that the service obligation would be unlimited as to time, in issuing a certificate to Sun Oil, the Commission had made no statement to that effect. This Court found no reason to distinguish the two situations. In construing Sun Oil's service obligation as unlimited, the Commission was not retroactively modifying the previously issued certificate, but simply spelling out the obligations inherent therein.

of the Act. See, e.g., California v. Southland Royalty Co., 98 S. Ct. at 1961; FPC v. Louisiana Power & Light Co., 406 U.S. at 632-34; Permian Basin Area Rate Cases, 390 U.S. at 777; United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392, 402-03 (1965); Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. at 142-43; Phillips Petroleum Co. v. Wisconsin, 347 U.S. at 685. In keeping with the approach of this Court in the above cited cases, we urge that this matter be remanded to the Commission for further proceedings designed to govern producer delivery obligations in a fashion consistent with the Natural Gas Act's concern for reliable service.

Respectfully submitted,*/

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

Nos. 77-1652, *ET AL.*

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

vs.

SHELL OIL COMPANY, *ET AL.,*
Respondents

On A Writ of Certiorari To The United States Court of Appeals for the Fifth Circuit

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BRIEF AMICUS CURIAE ON BEHALF OF ASSOCIATED GAS DISTRIBUTORS IN SUPPORT OF PETITIONERS

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On A Writ of Certiorari To The United States Court of Appeals for the Fifth Circuit

---

BRIEF AMICUS CURIAE ON BEHALF OF ASSOCIATED GAS DISTRIBUTORS IN SUPPORT OF PETITIONERS

QUESTION PRESENTED

Whether the "production or gathering" exemption of Section 1(b) of the National Gas Act renders the Federal Energy Regulatory Commission powerless to prescribe or enforce delivery standards under which the certificates or licenses issued to gas producer-sellers are to be exercised.

INTEREST OF AMICUS CURIAE

Associated Gas Distributors (AGD)[1] is an unincorporated organization comprising gas distribution companies serving over 11 million customers along the Eastern Seaboard, or approximately 25 percent of the nation's interstate gas customers. AGD member companies rely almost exclusively on interstate pipeline companies for pipeline gas supplies. As the principal pipelines supplying gas to the East Coast have sharply curtailed deliveries, beginning about 1970, AGD member companies have experienced increasing difficulty in providing adequate and reliable service to their customers, as required by various state laws governing utilities.

Since AGD companies depend heavily on gas supplies available to the interstate market, they are deeply concerned that the decision of the Court of Appeals will result in a lack of authority on the part of the Federal Energy Regulatory Commission (F.E.R.C. or the Commission) to prescribe or enforce delivery obligations for those producers which supply gas to the interstate gas system. AGD member companies will be adversely and directly affected if the decision of the Court of Appeals is upheld. Accordingly, AGD submits the present brief amicus curiae in support of petitioners.

Consent of the Parties

The written consent of the other parties has been obtained for the filing of this brief and is attached to the original, signed copy hereof.

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[1]The members of Associated Gas Distributors are listed on the inside cover of this brief.

ARGUMENT

I. The Court of Appeals' Decision Would Render the Commission Powerless to Protect the Consumer's Interest in An Assured Supply of Gas.

The issue before the Court is whether the Natural Gas Act confers on the Commission *any* power to prescribe or enforce the delivery standards under which the certificates or licenses issued to gas producer-sellers are to be exercised. The Court of Appeals struck down F.P.C. Order No. 539-B not because it was an unreasonable form of otherwise lawful producer certificate regulation. Nor did the Court below hold that the "prudent operator" standard of producer performance was arbitrary or that some other standard should have been considered. The Court ruled instead that the Commission was barred by the Section 1(b) "production or gathering" exemption[2] from adopting Order No. 539-B.[3] The specific terms of Order No. 539-B were apparently irrelevant to the Court of Appeals' decision. The holding below stands for the broad rule that the Commission is powerless to impose *any* performance or delivery standard which touches or impinges on the certificate holder's production function.

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[2]Natural Gas Act, 52 Stat. 821, 15 U.S.C. § 717(b). This Section provides, in pertinent part,

> The provisions of this act . . . shall not apply to . . . the production or gathering of natural gas.

[3]The Court of Appeals' opinion is addressed exclusively to the question of whether Order No. 539-B "is within the jurisdiction of the FERC" and holds that this order would "encroach on areas reserved to the states." *See FERC v. Shell Oil Co., et al.*, 566 F.2d 536, 540 (5th Cir. 1978).

A rule of such breadth strikes at the heart of the Commission's role as the agency responsible for the maintenance of adequate gas service to the interstate market.[4] In the course of discharging its initial licensing authority under Section 7 of the Natural Gas Act, the Commission annually issues hundreds of producer certificates authorizing the sale of gas at the wellhead, to the several interstate pipelines.[5] These producer certificates have come to represent the legal and factual basis on which the nation's huge pipeline and distribution network is licensed, financed and operated.[6] The millions of gas consumers served by the interstate gas system depend upon the integrity of these producer certificates for their daily energy supply. The economic stability of the interstate gas transmission and distribution industry depends on the producers' diligent and faithful performance of those wellhead sales contracts licensed by the Commission. In short, the service undertaken by a producer upon its acceptance of a sales certificate is one in which the *public* has a vital interest.

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[4] *See Atlantic Refining Co.* v. *Public Service Comm'n.*, 360 U.S. 378, 388 (1959); *FPC* v. *Transcontinental Gas Pipeline Corp.*, 364 U.S. 1, 19-20 (1961), and *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 631 (1972).

[5] *See* Federal Power Commission, 1976 Annual Report to Congress, January 4, 1977, p. 21.

[6] *See*, for example, 18 C.F.R. § 157.14(a)(10) and 18 C.F.R. § 260.7 requiring pipelines seeking authority to construct new facilities to present in support thereof extensive gas supply evidence, including contracts with gas producer-sellers.

The Commission's ability to prescribe and enforce general rules affecting or defining the producer-licensees' obligation to produce is essential to meaningful regulation of this public service. A certificate holder's role as a licensed *seller* of gas at the wellhead cannot be viewed in a vacuum, separate and apart from that party's role as a *producer* of gas. In the real world, the acts of producing and selling gas at the wellhead occur simultaneously and are performed by the same party. The quantity of gas sold is necessarily determined by the quantity of gas produced and vice versa. If the Commission is to regulate the *service* it is authorized to license, *i.e.*, the sale of gas at the wellhead, it can only do so by regulating to some extent or in some way the licensee's production activities. Conversely, if the Commission is by statute precluded from any scrutiny of its licensees' production activities, its ability to administer the Natural Gas Act in the public interest will be seriously hampered.[7]

The need for the Commission to exercise its regulatory power over the producer's service has become acute only in recent years. Since about 1970, there has been a general decline in the level of natural gas supply

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[7] The Court of Appeals' decision implies that the Commission's jurisdiction over producer-sellers' activities extends merely to the initiation of an interstate sale, for which a Section 7(c) certificate is required by *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), and to the termination or abandonment of service, for which a Section 7(b) certificate is required by *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137 (1960). What it ignores is the numerous instances between these two jurisdictional incidents when the Commission, sometimes at the producer-licensee's initiative, asserts jurisdiction over various aspects of the *production* function. *See MacDonald* v. *FPC*, 505 F.2d 355 (D.C. Cir. 1974).

available from regulated interstate gas pipelines.[8] Until this era of general and steadily increasing gas shortages, regulations to assure the maintenance of adequate service by companies licensed to sell gas at the wellhead were largely unnecessary. But in a climate of general shortage, the Commission would have been remiss if it had not exercised its authority to clarify and define the service obligations of those holding and acquiring licenses to deliver gas from producing reservoirs to the interstate market. Such regulation is not only timely but is essential to mitigate the public injury wrought by the gas shortage.

II. The Rule Adopted By the Court of Appeals Would Have Adverse Consequences For the Gas Consumer Beyond the Facts of This Case

The importance of this proceeding is not limited to the situation here, where the Commission promulgated a general interpretive rule to be applied in regulating and enforcing the delivery performance of licensed gas producer-sellers. At issue here is the Commission's ability to enforce or regulate its licensees' obligations to produce natural gas, regardless of the origin or source of that obligation. If the "production or gathering" exemption is as broad as the Court of Appeals regarded it, the Commission would be legally barred from *any* attempt to regulate effectively the wellhead sellers' service to the public.

An example of the broad purport of the Court of Appeals ruling is provided by considering the Commission's power to enforce a *contractual obligation* under which a producer-licensee agrees to observe

[8] *See* 1976 Federal Power Commission Annual Report to Congress, *op. cit.*, p. 16.

certain production or delivery standards. In the ordinary discharge of its duties, the Commission issues certificates to producing companies with respect to each individual new sale of gas from each new producing field or lease. The applications for these certificates are required to be accompanied by a copy of the executed gas sales contract whereby the producer-seller typically conveys gas at the wellhead to the interstate pipeline-transporter.[9] The typical gas sales contract submitted to the Commission contains provisions defining the seller's obligation to maintain deliveries of gas. In practice, these provisions vary widely from case to case. In some instances, the producer retains sole *discretion* to operate the lease, drill new wells, rework existing wells, etc. and do whatever it determines is appropriate to provide gas to the purchaser. In other instances, the producer agrees to supply a daily quantity of gas which represents a particular fraction of the total volume of gas reserves remaining in the reservoirs or under the acreage dedicated to the purchaser. In the latter situation, it is not unusual for the contract to provide for a periodic gas reserve determination to be made. Typically, these reserve determinations, *from which the producers' delivery obligation is derived,* are required to be made and agreed upon by both the seller and the buyer. In such a contract, the seller does *not* have sole discretion to produce or maintain deliveries at whatever level the producer finds appropriate; instead, the producer-seller is bound to manage its producing and drilling activity so that the required volume of gas deliveries is maintained.

[9] *See* 18 C.F.R. § 157.25.

When the Commission issues a producer certificate authorizing the commencement of service to an interstate pipeline, it consistently and routinely includes as part of its final certificate order a condition stating that the gas sales contract filed by the producer will be accepted as a "rate schedule" which becomes part of the Commission's official files.[10] In other words, when the Commission issues a certificate, it does so with reference to a particular contract which then becomes a part of the public record insofar as that producer-seller's ongoing service is concerned.

The facts described above present the context in which the sweeping effect of the Court of Appeals' decision may be seen. As indicated, the Commission in this situation certificates or licenses the producer's gas sales contract, *including* the producer's obligation to deliver gas at a defined level or volume. As the agency which has properly asserted its licensing jurisdiction over this contract, and which has an obligation to maintain adequate service to the public, it is reasonable to conclude or infer that the Commission is the forum in which the producer's delivery obligation can be enforced. Indeed, it would appear that the doctrine of primary jurisdiction would apply to any such enforcement action.[11]

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[10] *See*, for example, *Kerr-McGee Corp.*, 46 FPC 1113 (1971).

[11] *See Ashland Oil & Refining Co.* v. *FPC*, 421 F.2d 17 (6th Cir. 1970).

But the Court of Appeals' decision effectively bars any such enforcement action at the Commission *if the relief sought affects or impinges upon the seller-licensee's production activities.* It is conceivable, in the example provided above, that a pipeline could conclude that its producer-supplier was not delivering the daily volume required by its contract and that legal action was necessary to require the producer to do so. It is also conceivable that the cause of the producer's delivery deficiency was its failure to rework or maintain existing wells. The decision below, however, holds that the Commission would be barred from considering the pipeline's complaint or enforcement action in such a situation. This is true because, in the case presented, the remedy sought is addressed to the seller-licensee's *production activity, i.e.,* to the phase of its operations which the court has found beyond the Commission's reach. If the pipeline is unable to invoke the Commission's jurisdiction to enforce the delivery terms of contracts licensed by the Commission, *a fortiori* the Commission could not *sua sponte* initiate a proceeding of this kind, nor could a pipeline's customers do so.

The foregoing illustration demonstrates the policy dilemma thrust on the Commission by the Court of Appeals' decision. On the one hand, the Commission's mandate is to assure an adequate and reliable supply of gas to the nation's consumers. On the other, its power to pursue that objective is undermined and effectively cut off by the broad interpretation of the "production or gathering" exemption as applied to the service being rendered by licensees under outstanding Commission certificate orders.

The resolution of this dilemma is the task of this Court. In approaching that task, it should be recalled that

> "This Court has repeatedly held that the width of administrative authority must be measured in part by the purposes for which it was conferred."[12]

The "production or gathering" exemption, as broadly interpreted and applied by the Court of Appeals, stands squarely in the path of the Commission's effort to enforce producers' certificated contract obligations and thereby mitigate the public injury resulting from a generalized shortage of gas. To uphold the Commission's jurisdiction to take the action embodied in its Order No. 539-B would be to recognize again that the Natural Gas Act is "a comprehensive and effective regulatory scheme" under which the protection of the public interest is the primary value.

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[12] *Permian Basin Area Rate Cases*, 390 U.S. 747, 776 (1968).

CONCLUSION

The decision of the Court of Appeals is erroneous. If allowed to stand, it will significantly impair the effective administration of the Natural Gas Act. For the reasons stated above, we respectfully request the Court to reverse the decision below.

Respectfully submitted,

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November 16, 1978

CERTIFICATE OF SERVICE

I hereby certify that on this 16th day of November, 1978, copies of the foregong Brief Amicus Curiae On Behalf of Associated Gas Distributors In Support Of Petitioners were mailed, postage prepaid, to counsel for all parties of record.

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IN THE

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OCTOBER TERM, 1978

Nos. 77-1652 and
77-1654

FEDERAL ENERGY REGULATORY COMMISSION
Petitioner,

v.

SHELL OIL COMPANY, ET AL.
Respondent

AND

CONSUMER FEDERATION OF AMERICA,
ENERGY POLICY TASK FORCE
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION
Respondent

BRIEF OF ACTION ALLIANCE OF SENIOR CITIZENS OF GREATER PHILADELPHIA AS AMICUS CURIAE

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IN THE

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Respondent

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

Action Alliance of Senior Citizens of Greater Philadelphia (hereinafter, "Action Alliance") moves for leave to file the attached brief *amicus curiae* in the above captioned case. The consent to file the same was refused by counsel for Shell Oil Company thus necessitating this motion.

ARGUMENT

I. The Federal Energy Regulatory Commission Must Address the Problems of Economic Hardship Thrust Upon Consumers During the Current Gas Shortage by Enforcing the Certificated Delivery Obligations of Gas Producers

Rapidly increasing gas utility prices have been and will continue to be especially burdensome to elderly and low-income consumers in Pennsylvania. Said consumers pay a greater percentage of their incomes for gas service than do the affluent[1] and are least able to pay the perennial rate increases passed to them through fuel clauses by gas distribution companies. It should be understood that the escalating cost of gas service is due in large part to the current gas shortage.[2] The Federal Energy Regulatory Commission must address this specific problem by enforcing the certificated delivery obligations of gas producers.

It is noteworthy that by year end 1973, there were thirteen major interstate pipeline companies that were curtailing gas distribution utilities. This trend has continued to the present for many utilities. The Federal Power Commission (FPC)[3] addressed the above situation initially in the 1966-70 period when the supply problem first became evident. Specifically, the FPC approved steps toward sys-

[1] Dawn Day, *American Energy Consumer,* Ballinger Press (1976).

[2] Gas distribution companies in the face of curtailments by pipeline suppliers have no choice but to seek alternative sources of gas supply. Unfortunately, to accomplish this end increased costs to the customer are necessarily incurred. See discussion *infra,* f.n. 6.

[3] The Federal Power Commission was the predecessor of the Federal Energy Regulatory Commission (FERC).

tem expansion including increased sales volumes to many pipeline companies. The expansion of these systems facilitated the flow of gas to residential, commercial and industrial customers.[4]

In addition, during the years 1970 and 1971, the Federal Power Commission: (1) enacted favorable price ceilings to encourage exploration, (2) adopted various rule changes to facilitate pipeline investment and gas exploration, (3) permitted short-term producer sales to encourage dedication of reserves to the interstate market and, (4) required pipeline companies to file curtailment plans to foster the equitable allocation of short supplies.[5]

The above initial steps have not proven to be sufficient to mitigate the adverse economic impact of the current gas shortage, however. *The major challenge that faces the Federal Energy Regulatory Commission (FERC) at present is assuring the fulfillment of existing producer delivery obligations and devising new measures to allocate limited supplies among many classes of customers.*

The impact of the current gas shortage on local economies is significant in many respects and must be mentioned here. First, because of dwindling inventories of liquefied natural gas in storage tanks, local gas distribution companies have to seek alternative sources of gas supply. Many times this means negotiating emergency gas purchases from other pipeline systems at a premium price.[6] Alternatively, it can

[4] Federal Power Commission, National Gas Survey, Vol. I, p. 115 (1975).

[5] *Id.* at 116.

[6] The direct testimony of Joseph G. Horan of Philadelphia Gas Works in July 1977, Philadelphia Gas Commission hearings depicts the volatility of gas supply that leads to curtailments in many in-

mean the production of oil gas, carburetted water gas or synthetic natural gas (SNG).[7] Again, all the alternatives raised here are expensive processes and costs for the same are passed to consumers.[8] Second, because of inadequate supplies, distribution companies will in many instances forego providing seasonal sales to industry during summer months. That is, most procurements of flowing gas are needed for the winter period and are liquefied for storage.[9]

---

stances. It is noteworthy that in the 1976-1977 winter PGW's delivery entitlement of natural gas was temporarily reduced by 88,584 Mcf per day as a result of supply shortages: *Id.* at 10.

> Q. Earlier in your testimony you alluded to the volatility of the natural gas supply picture; can you cite an example of this volatility?
>
> A. The 1976-77 Budget, prepared in June of 1976, included a winter period flowing natural gas supply of approximately 36,500,000 Mcf (Thousand cubic feet), storage gas of 5,500,000 Mcf, no emergency purchases, and 4,100,000 Mcf, of LNG, for a total natural gas supply of 46,100,000 Mcf. In November 1976 the then current projection included a winter period flowing natural gas supply of 35,300,000 Mcf, storage gas of 6,000,000 Mcf, 2,000,000 Mcf of emergency purchases, 3,900,000 Mcf of LNG, for a total natural gas supply of 47,200,000 Mcf, an increase of 1,100,000 Mcf occasioned solely by PGW being able to offset a 1,300,000 Mcf decrease in flowing supply by the acquisition of an additional storage volume and PGW's ability to obtain a commitment from one of its pipeline suppliers to purchase 2,000,000 Mcf of emergency gas for PGW's account. It should be noted that although PGW's natural gas supply increased slightly, the increased cost of emergency and storage gas increased PGW's expenses by a disproportionate amount. *Id.* at 9-10.

[7] *Id.* at 16-18.

[8] Philadelphia Gas Commission Hearings, May 19, 1977, Tr. 5-8.

[9] Philadelphia Gas Commission Hearings, July 26, 1977, Tr. 435.

The loss of sales represents a loss of revenue making winter sales more expensive. Third, because of the critical gas shortage in severe winters, many industrial customers' service is curtailed causing loss of employment. This is particularly a crisis at a time when unemployment levels are already high.

Consumers here do not only address the pocketbook issue of higher rates which they can ill afford. Also, they voice vehement concern in regard to the burdens placed on industry as a result of the gas shortage. The specter of continued industrial curtailments mentioned above is a widespread occurrence. Philadelphia Gas Works has experienced reductions in its anticipated supply going into numerous past winter heating seasons.[10] Industrial curtailments naturally followed.[11] The experience of gas distribution companies across Pennsylvania was and is much the same. The Governor's Energy Council in Pennsylvania has outlined the problems created for large industrial customers by the gas shortage:

> Natural gas that is curtailed creates two direct impacts upon large gas consumers and [in] the geographic regions where they operate. One can be generically described as the impact of logistic problems of acquiring, transporting, storing and utilizing the alternate fuels. The other is the incremental cost of purchasing the alternative fuels. This section of the report examines these incremental costs and the amount of alternate fuels known to be required.
>
> These are not, however, the only impacts of alternate fuel usage. Other important impacts are very real and troublesome, even though less direct. Among these are the lost employment, diminished income, reduced purchasing power, and lower tax revenues that occur because alter-

[10] Philadelphia Gas Commission Hearings, July 19, 1977, Tr. 71.

[11] Philadelphia Gas Works, Proposed Change in Rates, p. 3 (1977).

nate fuels are not available or because the costs of alternate fuels raise product prices to non-competitive levels. Then there are the costs of designing and purchasing fuel storage and other combustion and heat transfer equipment to utilize alternate fuels.[12]

The Governor's Energy Council further states that there are many industrial customers who have no alternative fuel to secure in the event of curtailment. These customers are particularly vulnerable to the gas shortage and their employees are one class of apparent victims.[13]

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[12] Governor's Energy Council Commonwealth of Pennsylvania, Employment and Economic Impacts of Gas Shortages in Specific Counties and Industries of Pennsylvania, p. 24 (1977).

[13] The Governor's Energy Council report reveals the following statistics in regard to possible job dislocation as a result of the gas shortage in Pennsylvania:

1976/1977 HEATING SEASON PROJECTIONS
EMPLOYMENT BY LARGE CURTAILED CONSUMERS

County-specific Employment by Consumers Who:

a) Have No Alternate Fuel (Code 40)
b) Require No Alternate Fuel (Code 30)

Name of County	Total Employment by Large Curtailed Gas Consumers in the Specific County	Employment by Gas Consumers Who Do Not Have Alternate Fuel* (Code 40)	Employment by Gas Consumers Who Do Not Need Alternate Fuel* (Code 30)
Adams	948		
Allegheny	25685	2246	5755
Armstrong	315		
Beaver	20676	10623	3565
Berks	8899	76	
Bucks	10381		
Butler	376	341	
Cambria	60		60
Carbon	1396		1396
Centre	2245	1363	
Chester	8338	4600	4600
Clarion	409		

Name of County	Total Employment by Large Curtailed Gas Consumers in the Specific County	Employment by Gas Consumers Who Do Not Have Alternate Fuel* (Code 40)	Employment by Gas Consumers Who Do Not Need Alternate Fuel* (Code 30)
Clearfield	628	379	350
Clinton	46	46	
Columbia	1949	815	
Crawford	5630	2908	
Cumberland	1964		
Dauphin	7340		
Delaware	2915		
Elk	2982		
Erie	14987	534	
Fayette	1338		
Franklin	93		
Huntington	1198	860	
Jefferson	168	168	
Lackawanna	3383		471
Lancaster	10114		
Lawrence	3803		1609
Lebanon	2300		
Luzerne	1883	352	
Lycoming	525		
McKean	1041		
Mercer	9260	3135	
Mifflin	2037		
Montgomery	10716		1163
Northampton	14583		
Northumberland	2494		
Schuylkill	11202		
Union	100		
Venango	2204	1832	
Warren	2479		
Washington	5028	38	1588
Westmoreland	5044		1386
Wyoming	2647		
York	7847		5479
Total	209661	30286	27422

*For some portion of their curtailment. *Id.* at 2.

The question now becomes what can the FERC do to prevent the adverse economic impacts announced above. To be sure, it is firmly established that the primary aim of the Natural Gas Act is to "protect consumers against exploitation at the hands of natural gas companies." *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944). The Act's critical charge to the Commission includes the power to grant, deny and enforce certificates of public convenience and necessity, 15 U.S.C. § 717f. This Court has termed the certificate powers of the Commission as the "heart" of the Natural Gas Act. In *Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378, 388 (1957) the Court specifically states:

> . . . The Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges. The heart of the Act is found in those provisions requiring initially that any "proposed service, sale, operation, construction extension, or acquisition . . . will be required by the present or future public convenience and necessity," § 7(e), 15 U.S.C. § 717(e), and that all rates and charges "made, demanded, or received" shall be "just and reasonable,"§4, 15 U.S.C. §717 (c). The Act prohibits such movements unless and until the Commission issues a certificate of public convenience and necessity therefor, § 7(c), 15 U.S.C. § 717(c). Section 7(e) vests in the Commission control over the conditions under which gas may be initially dedicated to interstate use. Moreover, once so dedicated there can be no withdrawal of that supply from continued interstate movement without Commission approval.

Further, the primacy of the certificate over private contractual rights has been repeatedly recognized by this Court. *Sunray Mid-Continent Oil Co.* v. *Federal Power Commission*, 364 U.S. 137, 152 (1960); *Sun Oil Co.* v. *Federal Power Commission*, 364 U.S. 170 (1960).

In light of the above, the Commission's retreat from enforcing the certificate responsibilities of gas producers to

arrive at some vague and unworkable "prudent operator" standard premised on a contractual concept, is wholly unjustified. Moreover, such an abrogation of authority as announced in its Orders 539 A and B contravenes the thrust and meaning of the Natural Gas Act as construed by this Court. *Federal Power Commission* v. *Hope Natural Gas Co., supra.* It is also worthy of note that the end result of the Commission's Orders 539 A and B would be to grant gas producers virtually unregulated control over the deliverability of natural gas. Such result is unconscionable particularly in this time of crisis.

Consumers here ask not that the Commission immerse itself in the areas of production and gathering of natural gas, but rather that gas producers be held to their certificated responsibilities as opposed to such producer's unfettered (i.e., unregulated) discretion. This Court has dealt with similar problems under the Act in *Federal Power Commission* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 632. There, the Court opined that federal authority should govern where otherwise a given problem would escape effective regulation:

> . . . The Natural Gas Act of 1938 granted FPC broad powers "to protect consumers against exploitation at the hands of natural gas companies." *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 610, 88 L Ed 333, 349 64 S Ct 281 *Corp.*, 365 U.S. 1, 19, 5 L Ed 2d 377, 389, 81 S Ct. 435 (1944). See *FPC* v. *Transcontinental Gas Pipe Line* Corp., 365 U.S. 1, 19, 5L Ed 2d 377, 389, 81 S. Ct 435 (1961); *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 147 4 L Ed 2d 1623, 1631, 80 S Ct 1392 (1960). To that end, Congress "meant to create a comprehensive and effective regulatory scheme," *Panhandle Eastern Pipe Line Co.* v. *Public Service Comm'n*, 332 U.S. 507, 520, 92 L Ed 128, 139, 68 S Ct. 190 (1947), of dual state and federal authority. Although federal jurisdiction was not to be exclusive, FPC regulation was to be broadly complementary to that reserved to the States, so that there

would be no "gaps" for private interests to subvert the public welfare. This congressional blueprint has guided judicial interpretation of the broad language defining FPC jurisdiction, and 'when a dispute arises over whether a given transaction is within the scope of federal or state regulatory authority, we are not inclined to approach the problem negatively, thus raising the possibility that a "no man's land" will be created. Compare *Guss* v. *Utah Labor Board,* 353, U.S. 1 [1 L Ed 2d 601, 77 S Ct 598]. That is to say, in a borderline case where congressional authority is not explicit we must ask whether state authority can practicably regulate a given area, and, if we find that it cannot, then we are impelled to decide that federal authority governs." *FPC* v. *Transcontinental Gas Pipe Line Corp., supra,* at 19-20, 5 L Ed 2d at 390.

It is abundantly clear that the Congressional intendment here was to create a comprehensive and effective regulatory scheme. This means perforce that problems such as exist in the instant context should not "slip through the cracks" of the regulatory framework. Consumers submit that the decision of the Fifth Circuit below casts a pall over the authority of the Commission to implement an enforcement policy and must be reversed. Said decision fails to adequately recognize or address, the issue of the necessary powers of the Commission in regard to certificated "service" obligations. The economic consequences to consumers that would result from Commission inaction in the instant situation are indeed grave. In short, gas producers must be held to their certifiated obligations if consumers are to be provided adequate service and economic hardship is to be avoided.

CONCLUSION

For all the above reasons, the decision of the Fifth Circuit Court of Appeals should be reversed.

Respectfully submitted,

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1978

No. 77-1654

CONSUMER ENERGY COUNCIL OF AMERICA,

Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

No. 77-1652

FEDERAL ENERGY REGULATORY COMMISSION,

Petitioner,

v.

SHELL OIL COMPANY, *et al.*,

Respondents.

BRIEF FOR *AMICI CURIAE*, UNITED STATES CONFERENCE OF MAYORS, AMERICAN PUBLIC GAS ASSOCIATION, INDUSTRIAL UNION DEPARTMENT, AFL-CIO, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW), FARMERS' EDUCATIONAL AND COOPERATIVE UNION OF AMERICA (NATIONAL FARMERS' UNION)

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MOTION FOR LEAVE TO FILE BRIEF FOR *AMICI CURIAE*, UNITED STATES CONFERENCE OF MAYORS, AMERICAN PUBLIC GAS ASSOCIATION, INDUSTRIAL UNION DEPARTMENT, AFL-CIO, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW), FARMERS' EDUCATIONAL AND COOPERATIVE UNION OF AMERICA (NATIONAL FARMERS' UNION)

Pursuant to Rule 42, the United States Conference of Mayors, the American Public Gas Association, the Indus-

trial Union Department, AFL-CIO, United Automobile Aerospace and Agricultural Implement Workers of America (UAW), Farmers' Educational and Cooperative Union of America (National Farmers' Union) move to file the attached brief as *amici curiae* in support of the Petitioner, Consumer Energy Council of America (formerly the Energy Policy Task Force of the Consumer Federation of America) in No. 77-1654, and Petitioner, Federal Energy Regulatory Commission in No. 77-1552.

The *amici curiae* have obtained the written consent of the Solicitor General on behalf of the Federal Energy Regulatory Commission and of the Consumer Energy Council of America for the filing of the attached brief. However, not all of the Respondents, consisting of most of the major oil companies in the United States, have consented to *amici's* brief. Below in the court of appeals for the Fifth Circuit the *amici curiae* herein joined in filing a brief on the merits as *amici curiae* to that court, which was accepted.

The issues raised in this case concern the extent of the power and duty of the Federal Energy Regulatory Commission to enforce delivery obligations of producers of natural gas specified in certificates of convenience and necessity issued by the Commission under Section 7 of the Natural Gas Act. The *amici* who have joined in this brief represent millions of people throughout the United States who are dependent upon adequate and consistent supplies of natural gas delivered by the nation's interstate pipelines.

The court of appeals for the Fifth Circuit below, in deciding that the Federal Energy Regulatory Commission lacked jurisdiction under the Natural Gas Act to set reasonable terms and conditions for the delivery of natural gas by producers selling gas in interstate commerce

to the nation's interstate pipeline companies when issuing certificates for such deliveries under Section 7 of the Natural Gas Act of 1938, 15 U.S.C. §717 *et seq.* would leave the Commission powerless to require the production of any volumes of gas for the service of interstate consumers.

The *amici curiae* believe that the position that they have set forth in their brief, stressing the existing regulations under Section 7 of the Natural Gas Act, and the established system of certificates containing express evidence of deliverability requirements for the pipelines, are matters which have not been presented by the parties and are clearly relevant to the disposition of the case. Under the certificates presently issued to the nation's interstate pipelines, concrete details of deliverability requirements had been presented to the Commission, backed up by specific contracts between the pipelines and producers, which had been ruled upon by the Commission in issuing certificates. Indeed, the detailed exhibits required by the Commission's regulations setting forth the deliverability requirements of gas supply have been the keystone upon which billions of dollars have been spent by the pipelines and distributors in constructing facilities to serve consumers over the years. *Amici* submit that these facts and long standing administrative practice under the Commission's Regulations dealing with certificates will not be presented by any other party and are relevant to the disposition of the case.

For the foregoing reasons, the *amici curiae* move that the attached brief be accepted by the Court for filing.

Respectfully submitted,

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INTEREST OF *AMICI CURIAE*

Pursuant to Rule 42, the United States Conference of Mayors, the American Public Gas Association ("APGA"), the Industrial Union Department, AFL-CIO,

United Automobile, Aerospace and Agricultural Implement Workers of America ("UAW"), Farmers' Educational and Cooperative Union of America (National Farmers' Union) submit this brief as *amici curiae* in support of the petitioner, Consumer Energy Council of America (formerly the Energy Policy Task Force of the Consumer Federation of America) in No. 77-1654) and petitioner, Federal Energy Regulatory Commission in No. 77-1652.

The issues raised in this case concern the extent of the power and duty of the Federal Power Commission to enforce the delivery obligations undertaken by producers of natural gas when they accept certificates of public convenience and necessity from the Commission. The *Amici* who have joined in this brief represent millions of people throughout the nation who depend on adequate and consistent supplies of natural gas for their necessities of life and for their livelihood.

The United States Conference of Mayors is an organization of the mayors of the 750 cities in the United States whose populations exceed 30,000 people and, since its founding in 1933, has become a unique national representative of urban interests. Any reduction in the supply of natural gas would seriously compromise the ability of any of these cities to maintain essential municipal services. The present crisis finds the cities encumbered with extensive investments in natural gas facilities, created in reliance on the presumed continuity of the supply of this gas; and their residents depend on it for fuel and heat. The cities are also subject to regulations, such as those of the Federal Clean Air Act, which make their reliance on natural gas more desperate. Forced conversion to coal or oil without adequate lead time to assess the impacts of

such conversion can only increase the complexity of a city's struggle for compliance with those regulations. Cities are also the primary centers of national economic activity: manufacturing and food processing are but two of the major industries, concentrated in cities, which would suffer gross, adverse consequences from any significant reduction in the supply of gas. The unemployment and loss of tax revenues caused by these shortages would further tax already overburdened municipal services.

The American Public Gas Association is an association of approximately two-hundred publicly owned gas distribution systems located throughout the United States. APGA is vitally concerned with obtaining adequate supplies of natural gas for its members, so that they can adequately perform their public responsibilities; and it has been a frequent party in Federal Power Commission proceedings and cases on issues related to those now before this Court.

The labor organizations which join as Amici represent millions of workers and their families who depend on natural gas, both as it relates to their means of livelihood and as a source of domestic heat and fuel. The Industrial Union Department (IUD) is a department of the AFL-CIO which seeks to promote the common interests of workers who belong to industrial unions. IUD consists of fifty-six national and international unions within the industrial sector having a total membership in excess of six million working men and women employed throughout the United States. Workers represented by IUD depend upon an uninterrupted flow of gas in two ways: First, as consumers its members are directly affected when natural gas supplies

fall short. Second, as employees of industries throughout the country, IUD's members are faced with layoffs when gas supplies fail at their plants, and with an array of adverse consequences which flow from the economic upheaval produced in their industries when the cost of a vital energy source spirals because of artificial shortages. IUD members have already experienced such problems to an alarming and increasing degree. The United Automobile, Aerospace and Agricultural Implement Workers of America (UAW) is the largest industrial union in the world. It represents approximately one million four hundred thousand members. If the families of these workers are included, the UAW represents more than four and a half million persons throughout the United States and Canada. The UAW is mandated by its Constitution and tradition to become involved in the issues concerning the quality of life and is vitally concerned with its members' rights as employees and citizens.

The cases before the Court involve a major issue in the administration of the Natural Gas Act of 1938 ("NGA") 15 U.S.C. §717 et seq. as heightened by the recently enacted amendments thereto in the Natural Gas Policy Act of 1978 ("NGPA") Act of November 9, 1978, Pub. L. No. 95-621, which vitally affects the nation's consumers of natural gas. The court of appeals for the Fifth Circuit below in deciding that the Federal Energy Regulatory Commission lacked jurisdiction under the Natural Gas Act to set terms and conditions for the delivery of natural gas by producers selling gas in interstate commerce to the nations' interstatement pipeline companies when issuing certificates for such deliveries under Section 7 of the NGA, reverses *sub silentio* years of precedents by this Court and lower

federal courts and vests the producers with new carte blanche powers to refuse to deliver previously-certificated volumes of gas necessary to supply interstate consumers. That the court in so doing reversed the Federal Power Commission's Order No. 539-B is ironic because that order in establishing a new standard of "prudent operator" for producers had seriously undermined its existing powers to enforce the requirements of the Natural Gas Act as they relate to deliverability and the rendition of natural gas service under certificated arrangements pursuant to the Act.

Since the net impact of the Commission's Order No. 539-B was to seriously impair the enforcement of deliverability by producers, and the holding of the court below to deny it altogether, the *amici curiae*, dependent on the continued availability of interstate gas from existing certificates, have been adversely affected. The widespread curtailment by interstate pipelines of distributors holding long-term firm contracts for the delivery of gas based upon certificates previously issued by the Commission containing express findings of deliverability of specified minimum volumes of natural gas by producers to the pipelines which has not been met, have adversely impacted *amici* as well as interstate consumers throughout the nation.[1]

Not only do the decisions below adversely affect *amici* and other consumers in terms of assuring deliverability by producers of existing committed supplies, but

---

[1] The Commission reported that curtailments by interstate pipelines of firm customers reached 3,379,672 million cubic feet in the period April 1977 to March 1978 and were projected to increase to 3,898,812 million cubic feet April 1977 to March 1978. *Final Annual Report, 1977*, Federal Power Commission (July, 1978), p. 18.

they also can have an important impact on the prices paid by consumers for gas. Natural gas prices have been met by the Commission in a series of area rates,[2] followed by national rates,[3] which in each instance allowed a higher price for "new" gas for wells drilled after certain dates than for "old" gas in older wells previously committed to interstate commerce. The Natural Gas Policy Act of 1978 retains distinction between the pricing of "old" and "new" gas in establishing new ceilings for natural gas. To the extent that the Commission cannot order producers in issuing certificates of convenience and necessity under Section 7 of the Act to meet any deliverability standards from existing committed supplies of old gas, the producers can refuse to deliver gas from such committed old wells and shift to deliver gas from new wells at higher prices. Thus the power in the Commission to enforce meaningful terms and conditions governing deliverability from wells committed to interstate commerce is essential, both to the enforcement of certificated supplies to lessen curtailments and to protect consumers from the adverse price consequences of vesting unlimited discretion in producers to withhold lower-priced old gas supplies in favor of higher priced new gas supplies.

QUESTIONS PRESENTED

1. Whether the "prudent operator standard" enunciated in the Federal Power Commission's Order 539-B constitutes a proper measure for enforcing the interstate

---

[2] *See, e.g.*, Permian Basin Area Rate Cases, 390 U.S. 747 (1968).

[3] American Public Gas Association v. FPC, 567 F.2d 1016 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978).

delivery obligations of natural gas producers under certificate of public convenience and necessity issued pursuant to Section 7 of the Natural Gas Act.

2. Whether the Federal Energy Regulatory Commission is precluded by the "production and gathering" exemption contained in Section 1(b) of the Natural Gas Act from enforcing, in accordance with an appropriate standard, producers' certificated delivery obligations.

ARGUMENT

I.

THE COMMISSION BELOW ERRED IN ORDER 539-B IN ABANDONING THE REQUIREMENT OF ITS LONG-STANDING REGULATIONS TO SET FORTH CLEAR DELIVERABILITY OBLIGATIONS WHEN ISSUING CERTIFICATES AND IN IMPOSING IN PLACE THEREOF THE VAGUE "PRUDENT OPERATOR" TEST WHICH LEFT DELIVERABILITY LARGELY IN THE HANDS OF THE PRODUCERS.

A. The Certificate System Under Section 7 of the Natural Gas Act Has Provided the Structure for the Construction and Development of the Entire Interstate Gas System Now Serving Consumers in the United States.

The background of the existing structure of the interstate gas industry serving consumers in the United States rests on Section 7 of the Natural Gas Act, 15 U.S.C. §717c, enacted in 1938. Section 7 of the Act provides that, except for certain preexisting grandfathered facilities, no sale of natural gas subject to the jurisdiction of the Commission[4] could take place without obtaining a certificate of convenience and necessity from the Commission:

---

[4] The issue of the scope of the Commission's jurisdiction, as ruled upon by the court below, is treated at pp. 18 *infra*.

(c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction on extension shall engage in the transportation or sale of natural gas subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations.

* * *

. . . the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: . . . . (15 U.S.C. §717f(c).)

Section 7(e) of the Act authorized the Commission in issuing a certificate to set forth the terms and conditions to govern service thereunder:

> . . . a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acqusition covered by the application, if it is found that the applicant is able and willing properly to do the acts *and to perform the service proposed and to conform* to the provisions of this chapter *and the requirements, rules, and regulations of the Commission thereunder,* and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent

> authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. *The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as to public convenience and necessity may require.* (15 U.S.C. §717f(e); emphasis added.)

That Congress contemplated that deliveries of supplies of natural gas would be specified in the certificates is clear from the language of Section 7(b) of the Act, barring abandonment of service without express Commission authorization:

> (b) *No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities,* without the permission and approval of the Commission first had and obtained, after due hearing, *and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted,* or that the present or future public convenience or necessity permit such abandonment. (15 U.S.C. §717f(b); emphasis added.)

Pursuant to Section 7, the Commission early issued detailed regulations governing applications thereunder for certificates. The purpose and intent of the rules was prescribed in the regulations as follows:

> §157.5 *Purpose and intent of rules*
>
> (a) Applications under section 7 of the Natural Gas Act shall set forth all information necessary to advise the Commission fully concerning the operation, sales, service, construction, extension, or acquisition for which a certificate is requested or

the abandonment for which permission and approval is requested. . . . Applications for permission and approval to abandon pursuant to section 7(b) of the Act shall conform to §157.18 and to such other requirements of this part as may be pertinent. However, every applicant shall file all pertinent data and information necessary for a full and complete understanding of the proposed project, including its effect upon application's present and future operations and whether, and at what docket, applicant has previously applied for authorization to serve any portion of the market contemplated by the proposed project and the nature and disposition of such other project.

(b) Every requirement of this part shall be considered as a forthright obligation of the applicant which can only be avoided by a definite and positive showing that the information or data called for by the applicable rules is not necessary for the consideration and ultimate determination of the application.

(c) This part will be strictly applied to all applications as submitted and the burden of adequate presentation in intelligible form as well as justification for omitted data or information rests with the applicant. (17 Fed. Reg. 7386, Aug. 14, 1952, as amended by Order 280, 29 Fed. Reg. 4876, Apr. 7, 1964, 18 CFR, §157.5)

The regulations specifically set forth the exhibits required by a pipeline applicant for a certificate requiring detailed information about gas supply, deliverability and the volumes of gas reserves available under each contract with a producer:

§157.14 *Exhibits*

(a) *To be attached to each application.* All exhibits specified shall accompany each application when tendered for filing . . .

* * *

(10) *Exhibit H—Total gas supply data.* A statement of the total gas supply committed to, controlled by, or possessed by applicant which is available to it for the acts and the services proposed, together with:

(i) The estimated remaining recoverable salable gas reserves available to applicant submitted in the form and containing all the data and information required by FPC Form No. 15, Annual Report of Gas Supply. (See §260.7 of this chapter.)

(ii) *Deliverability studies showing the volumes of natural gas which can and are proposed to be obtained each year submitted in the form* and containing the data and information as required by FPC Form No. 15, Annual Report of Gas Supply.

(iii) *The names and addresses of persons with whom applicant has gas-purchase contracts and the estimated volumes of gas reserves applicant has available under each contract,* segregated by gas fields and reservoirs thereof with names and locations of fields (State, county or parish).

(iv) The maps required by FPC Form No. 15, Annual Report of Gas Supply.

(v) A conformed copy of each gas-purchase contract upon which applicant proposes to rely. . . ." (18 CFR §157.14(a)(10); emphasis added).

Thus, a pipeline seeking to construct or enlarge its facilities for the service of consumers has been required to set forth in its certificate application precise data on the supply of natural gas and deliverability studies of the volumes of natural gas that can be produced as well as the contracts and reserves with producers supporting such deliverability.[5] Other sections of the regulations

[5] Transwestern Pipeline Company, *et al.*, FPC Op. No. 574, 43 FPC 322, 331-39 (1970); Transwestern Pipeline Company, *et al.*,

[footnote continued]

provide for notice of all applications to be given, so that any producer not agreeing with the representatives by the pipeline applicant as to the deliverability of reserves from his contract, can petition to intervene. 18 CFR §157.9.[6] The major decisions on the supply of gas necessary for a project would be made as a condition precedent to the issuance of a certificate therefor.

It is clear that the entire existing structure of the interstate system serving natural gas to ultimate users is premised upon the certificates previously issued by the Commission under Section 7 of the Act and the regulations thereunder set forth above. Billions of dollars have been spent by interstate pipeline companies to build and construct their present pipeline systems to their present capacity. At the heart of each application by an interstate pipeline to construct or expand its pipeline system has been its certificate application containing therein the specific deliverability studies and gas supply data, based on specific contracts with producers to demonstrate that in fact the new investment proposed would have an adequate supply of gas from the producers. Based upon this concrete specific factual evidence of deliverability and supply, the interstate pipelines have been authorized through the issuance of the certificates to enter new contracts with each of its distributor customers to provide firm deliveries. In reliance on their new firm contracts, each

FPC Op. No. 500, 36 FPC 176, 210-12 (1966), *aff'd*, Southern Calif. Edison Co. v. FPC, 387 F.2d 619 (3d Cir. 1967), *cert. denied*, 392 U.S. 909 (1968); and Northern Natural Gas Co., *et al.*, FPC Op. No. 618, 47 FPC 1202, 1215-16 (1972).

[6] As this Court noted in *State of California v. Southland Royalty Co.*, 436 U.S. 519, 56 L.Ed. 2d 505, 513 (1978), the respondents could have intervened in the certificate proceedings before the Commission, but there did not do so.

of the distributors in turn have invested substantial sums of money within its distribution system to serve its retail users.

B. Order No. 539-B Establishing A New "Prudent Operator" Standard Departed From the Requirement of the Regulations For Compliance With Prior Certificated Deliverability Volumes.

As originally promulgated, Order No. 539, issued by the Federal Power Commission on October 14, 1975 set forth a "statement of policy" "with respect to the enforcement of the requirements of the Natural Gas Act . . . as they relate to deliverability and the rendition of natural gas service under certificate arrangements pursuant to that act." In Order No. 539, the Commission set forth its resolve to insure that certificated arrangements for the delivery of natural gas would be enforced. The Commission stated:

Enforceability of Certificated Arrangements—Upon commencement of jurisdictional sales or services, this Commission has full authority to enforce the rendition of, *inter alia*, natural gas services, sales or operations, as certificated by the Commission, including as a part thereof, necessary deliverability or production of natural gas to meet, inter alia, certificated operations, services, developments, quantities, volumes or sales.

As certificated, such factors may or may not accord with the terms of sales or other contractual arrangements among natural gas producers, pipelines or distributors in seeking Commission authority to engage in jurisdictional sales or services. To the extent that contractual obligations coincide with the certification authority, these factors are thus also enforceable as a matter of

private contract law. However, it is the statutory standards of the Natural Gas Act which ultimately control the terms under which natural gas companies may operate jurisdictional facilities and engage in jurisdictional transactions. Certificated obligations are enforceable by pipelines as a matter of the private law of contracts as well as by this Commission as a matter of public regulatory law.

The Commission then ordered the addition of a new section 2.83 to its "General Policy and Interpretations" under its regulations as follows:

> *2.83 Policy With Respect To Enforcement Of Deliverability And Rendition Of Natural Gas Services Under Certificated Arrangements.*
>
> (a) Natural Gas Companies within the meaning of Section 2(6) of the Natural Gas Act (whether producers or pipelines) shall comply with all deliverability or production of natural gas requirements to meet, *inter alia,* certificated operations, services, developments, quantities, volumes, or sales. The standards of compliance shall be the controlling statutory standards of the Natural Gas Act, chiefly those of Sections 4, 5, and 7 thereof. The certificate of the Commission authorizing jurisdictional transactions under the Natural Gas Act shall be deemed evidence of those requirements, whether or not specifically reproduced within the certificate document or order. Natural gas pipeline companies and natural gas producers have obligations arising from the Natural Gas Act with respect to, *inter alia,* deliverability and receipt of certificated volumes of natural gas supplies, violation of which obligations will subject either to the sanction and/or penalty provisions of that Act. While this Commission is charged with responsibility of the administration of the Natural Gas

> Act, regulated pipelines and producers have affirmative obligations to enforce delivery of certificated volumes of natural gas supplies by reasons of the requirements of that Act.

As such, Order 539, as originally issued by the Federal Power Commission, clearly required the enforcement of existing certificated volumes of natural gas supplies by producers.

A number of producers filed for rehearing, and the Commission granted rehearing and issued Order 539-A on March 26, 1976. Order 539–A reaffirmed Section 2.83 of the Commission's general policy and interpretations with two minor amendments to Section 2.83(d). In Order 539-A, the Commission, however, granted the Motion of Shell Oil Company for an oral argument relating to Section 2.83.

After oral argument, the Commission on July 30, 1976, issued Order No. 539-B, which reversed the prior orders, deleted Section 2.83 from the statements of General Policy and Interpretation of the Commission, and inserted a completely new Section 157.41 of the Commission's Regulations incorporating the "prudent operator" standard. Ordering paragraph (B) of Order 539-B provided as follows:

> (B) The Commission, acting pursuant to its authority under the Natural Gas Act, as amended, particularly Sections 4, 5, 7 and 16 thereof, 15 U.S.C. 717c, 717d, 717f, and 717o, hereby orders that its General Rules, Title 18 of the Code of Federal Regulations, be amended by adding a new Section 157.41 as follows:
>
> On and after July , 1976, all certificates of public convenience and necessity for the sale of natural gas for resale in interstate commerce shall be conditioned as follows:

> All persons making jurisdictional sales pursuant to the authority granted by this certificate are hereby given notice that the contractual obligations between the buyer and the seller are incorporated into the certificate obligations, and that the certificate is further conditioned to require that the seller shall observe the standard of a prudent operator to develo and maintain deliverability from reserves dedicated hereunder.

The major failing of Order 539-B lies in its substantial departure from the longstanding prior regulations of the Commission wherein the deliverability, reserves and actual contracts providing for gas deliveries are specified in the certificate applications upon which final certificates are issued. Despite the express exhibits showing the actual deliverability requirements from the particular contracts and leases involved, in the future the producers could refuse to comply with these deliverability requirements on the ground that it was not consistent with their responsibilities as a "prudent operator." Thus, in place of concrete deliverability requirements set forth in the certificates, the producers can avoid delivering any such volumes on the ground that it is inconsistent with their responsibilities as a "prudent operator." If the producers can now rely upon the vague, undefined standards of a "prudent operator", the objective deliverability requirements of the certificates will become meaningless or severely watered down.

The Commission in Order 539-B never really gave a clear definition as to what it means by the prudent operator standard. At the outset, it appears that the Commission relied upon some implied convenant in lease agreements or some vague standards to comply with state regulatory conservation requirements. The

very vagueness of the standard as elucidated by the Commission in Order 539-B reveals its impropriety. Any implied convenants in lease agreements, have little or nothing to do with the enforceability requirements of federal certificates, necessary to protect interstate consumers to ensure the delivery of certificated volumes of gas, upon which millions of dollars have been spent in reliance on firm gas supplies. The Commission does not state that this "implied convenant in lease agreements" is identical to provisions of state regulatory agencies dealing with conservation of natural resources. The provisions of any state law pertaining to conservation are not set forth and analyzed. Furthermore, the operations of a producer under state law to preclude the waste of natural gas, undoubtedly would be completely different than a requirement issued by the Federal Energy Regulatory Commission to require the production of certain volumes of natural gas to meet consumer requirements in times of curtailment.[7]

The Commission's retreat in Order 539-B to the standard of "prudent operator," derived from vague references to lease operator or conservation standards under state law, cannot substitute for clear precise certificate responsibilities established by the Commission under Section 7 and the regulations thereunder. As such, the Commission's action in Order 539-B is contrary to the position it took when asked to rely on local law as a reference

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[7] Furthermore, the Commission's reference to the requirements of the Department of Interior relating to its offshore regulations is similarly not in point. The Commission has made no showing that the Department of Interior regulations dealing with offshore leases have anything to do with the requirements set forth in Section 7 of the Natural Gas Act and the Commission's longstanding regulations thereunder which require certain specified deliveries of natural gas volumes in order to supply certificated facilities authorized under the Act.

point in determining whether service had been abandoned under Section 7(b) of the Act once previously certificated. This Court has recently held in *State of California, et al. v. Southland Royalty Company, et al.*, 436 U.S. 519, 56 L.Ed.2d 505 (1978) that the Commission would abdicate its statutory powers if it relied upon state law in those cir..mstances:

> We conclude that the Commission acted within its statutory powers in requiring that respondents obtain permission to abandon interstate service. 'A regulatory statute such as the Natural Gas Act would be hamstrung if it were tied down to technical concepts of local law.' *United Gas Improvement Co. v. Continental Oil Company*, 381 U.S. 392, 400 (1965). By tying the concept of dedication to local property law, respondents would cripple the authority of the Commission at a time when the need for decisive action is greatest. Guided by *Sunray*, we believe that the structure and purposes of the Natural Gas Act require a broader view of the Commission's authority. (56 L.Ed.2d at 514.)

II.

THE DECISION BELOW OF THE COURT OF APPEALS FOR THE FIFTH CIRCUIT BARRING COMMISSION JURISDICTION TO SET REASONABLE TERMS AND CONDITIONS FOR THE DELIVERABILITY OF NATURAL GAS IS CLEARLY IN ERROR.

The court of appeals below in holding that the FERC is prohibited by the specific exclusion of the "production and gathering of natural gas" set forth in Section 1(b) of the Natural Gas Act, 15 U.S.C. §717(b) from imposing any terms and conditions in certificates upon

delivery requirements, is patently erroneous, and would overrule *sub silentio*, years of prior precedents by this Court.

First, the court's decision below is inconsistent with the long line of cases to the effect that the FERC can enforce "service obligations" contained in the certificates that it issues to producers, preventing producers from ceasing deliveries from fields admittedly capable of continuing production. *Sunray Midcontinent Oil Company v. FPC*, 364 U.S. 137 (1960) and *Sun Oil Company v. FPC*, 364 U.S. 170 (1960). This Court recently reaffirmed the principle of those decisions in *State of California, et al. v. Southland Royalty Company, et al.*, 436 U.S. 519 (1978). In the *Southland Royalty Company* case, this Court held as follows:

> . . . in *Sunray Mid-Continent Oil Co. v. Federal Power Commission, supra*, the Court recognized that the obligation to serve the interstate market imposed by a certificate of unlimited duration could not be terminated by private contractual arrangements. In that case, a producing company which had contracted with a pipeline to supply gas for 20 years sought a certificate from the Commission limited to that period. The Commission insisted on a permanent certificate; and this Court upheld its authority to do so, holding that even after the contract expired, the producer would remain under an obligation to supply gas to the pipeline, unless permission to abandon service had been obtained. The obligation on the producer which survived after the contract term "will not be one imposed by contract but by the act." 364 U.S., at 155. The obligation to continue the service despite the provisions of the sale contract was held essential to effectuate the purposes of the Act; otherwise producers and pipelines would be

free to make arrangements that would circumvent the ratemaking and supply goals of the statute. *Id.*, at 142-47.

Similar principles control this case. The issuance of a certificate of unlimited duration covering the gas at issue here create a federal obligation to serve the interstate market until abandonment had been obtained. . . . Just as in *Sunray*, the service obligation imposed by the Commission survived the expiration of the private agreement which gave rise to the Commission's jurisdiction.

The Commission "had long drawn distinction between the underlying service to the public a natural gas company performs and the specific manifestation—the contractual relation—that the service takes at a given moment." *Id.*, at 152. Just as the federal obligation is held paramount to private arrangements in *Sunray*, that obligation must be recognized here. Once the gas commenced to flow into interstate commerce from the facilities used by the lessees, §7(b) required that the Commission's permission be obtained prior to the discontinuance of 'any service rendered by means of such facilities.' Private contractual arrangements might shift control of the facilities and thereby determine *who* is obligated to provide that service, but the parties may not simply agree to terminate the service obligation without the Commission's permission. 56 L.Ed.2d at 510-11.

Clearly, if the Commission under certificate powers conferred by Section 7 of the Natural Gas Act has the power to assure that service once commenced continues beyond the end of the contract, *a fortiori*, the Commission has power to require that certificated service deliverability should continue during the term of the contract. Without this authority, the requirements

of Section 7 for continued service, and the particular requirements of Section 7(b) against abandonment, could be rendered meaningless. If the Commission lacks jurisdiction over continued service and deliverability requirements, the producers would be free to simply reduce service to a *de minimis* amount. This would be tantamount to a constructive abandonment over which the FERC would be powerless to act. Clearly, the Commission's authority to require the continuation of service under the *Sunray* case, and *Southland Royalty* cases, of necessity contains the authority to prescribe the reasonable terms and conditions for the continuation of such service; otherwise, the authority to continue service is a shadow.

The decision of the court of appeals below ruling that the Commission lacks jurisdiction under Section 7 to order standards for the delivery of natural gas by producers, would reverse long years of established practice under the Commission's regulations. As noted, *supra*, the Commission has for many years required certificate applications to include detailed exhibits showing the deliverability of natural gas and the reserves, which provide the whole underpinning for the proposed expansion of certificated service by interstate pipelines. 18 C.F.R. §157.14(a)(10). Without the power to enforce representations by producers and pipelines as to the deliverability requirements upon which pipeline expansions have taken place and billions of dollars expended, the certificates of the Commission will be based upon a shifting house of sand. Such a result is inconsistent with the express language of Section 7(b) which authorizes a natural gas company to obtain an abandonment only after first seeking the permission and approval of the Commission and the presentation of

evidence to obtain "a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permits such abandonment." 15 U.S.C. §717(f)(b). This language of Section 7(b) of the Act would be meaningless surplusage if the Commission lacks jurisdiction to set reasonable terms and conditions for the continued service of specified volumes of natural gas under a certificate. Similarly, Section 4(b) of the Act provides that "unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, *or service*, or any rule, regulation, or contract relating thereto, except after 30 days' notice to the Commission and to the public." 15 U.S.C. §717(c)(d); emphasis added. To the extent that natural gas deliveries have been certificated from producers to interstate pipelines as part of the certificate, Section 4(d) of the Act requires their continuation without prior approval obtained from the Commission.

The contention by the court of appeals below that the jurisdiction of the Commission to specify service requirements is limited by the exemption of Section 1(b) is misplaced. The specification by the Commission of deliverability requirements upon the issuance of a certificate is similar to the specification of the wellhead rate at which the gas should be sold, and neither involves a violation of the second clause of Section 1(b).

In *Phillips Petroleum Company v. Wisconsin*, 347 U.S. 672 (1954), this Court considered at length the meaning of the second clause of Section 1(b) and concluded that the affirmative grant of jurisdiction over

sales by producers to interstate pipelines in the first clause of §1(b) is not limited by the negative second clause of this section excluding "production or gathering of natural gas":

> . . . In our view, the statutory language, the pertinent legislative history, and the past decisions of this Court all support the conclusion of the Court of Appeals that Phillips is a 'natural-gas company' within the meaning of that term as defined in the Natural Gas Act, and that its sales in interstate commerce of natural gas for resale are subject to the jurisdiction and regulation by the Federal Power Commission.

Since the rates for the "sales" from the producer to the interstate pipeline are subject to Commission jurisdiction, terms and conditions set by the Commission for the continuation of service under such sales are similarly subject to the Commission's jurisdiction; neither involves any Commission intrusion into the limited exemption for "production and gathering" in the second clause of Section 1(b).

Closely in point here is the Supreme Court's decision in *United Gas Improvement Company v. Continental Oil Company*, 381 U.S. 392 (1965) (Rayne Field). There, producers having unsuccessfully sought to obtain a high sales price for the gas from Rayne Field, cancelled their sales contracts and proposed to sell their leasehold interests in the Rayne Field lands in which the natural gas was located to the pipeline, Texas Eastern. The gas reserves in Rayne Field were proven, and the field substantially developed. After asserting jurisdiction over the lease-sales, the Commission concluded that it would not be in the public interest to certificate them because of the inability to effectively regulate the unit sales. The Fifth Circuit Court of

Appeals reversed holding that the leases involved "relate to the production or gathering of natural gas and are thus outside the Commission's jurisdiction." (*M.H. Marr v. FPC*, 336 F.2d 320, 325 (1964)). The Supreme Court reversed, holding that the production and gathering language of the second clause of Section 1(b) did not deprive the Commission of jurisdiction over the transaction:

> We turn then to the question whether these lease-sales, even though sales of natural gas within the meaning of the Act, are nonetheless outside Commission jurisdiction because of the exemption for "production or gathering."
>
> The statement in Phillips that "production and gathering, in the sense that those terms are used in §1(b), end(ed) before the sales by Phillips occur(red)" 347 U.S., at 678 97 L.ed at 1045), could be read to turn the "production or gathering" exemption purely on a matter of the timing of the title transfer. That would mean, of course, that the lease-sales here involved were within the production or gathering exemption, for at the time of the transfer the gas was still in the ground. The same would be true for any sale of gas in place. Acceptance of any such narrow interpretation would make Phillips a shadow. Its substance lies, instead, in the judgment that "(p)rotection of consumers against exploitation at the hands of natural-gas companies was the primary end of the Natural Gas Act," id., at 685, 98 L.ed at 1049, and "congressional intent (was) to give the Commission jurisdiction over the rates of all wholesales of natural gas in interstate commerce." Id., at 682, 98 L.ed. at 1047. We have not limited Phillips to a matter of the timing of the transaction, see Cities Service Gas Co. v. State Corp. Comm'n of Kansas,

355 U.S. 391, 2 L.ed 2d 355, 78 S. Ct. 381, reversing, per curiam, 180 Kan. 454, 304 P.2d 528, and considered that it would be a mistake to do so.

> We conclude that even though a sale of natural gas in interstate commerce occurs before production or gathering is ended, it is nonetheless subject to regulation. In the context of such a sale, as distinguished from the situation in FPC v. Panhandle Eastern Pipe Line Co., 337 U.S. 498, 93 L.ed 1499, 69 S. Ct. 1251, to be discussed hereafter, the "production or gathering" exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction. This accommodation of the two relevant clauses of §1(b) gives content to the national objectives of the Natural Gas Act as expounded in Phillips, and to the Commission's jurisdiction to accomplish them, while in no way interfering with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate state concerns. (381 U.S. 402-03.)

Thus, the holding of the court of appeals below which apparently would preclude the Commission from jurisdiction to establish deliverability requirements to govern sales by producers to interstate pipelines in interstate commerce would in effect reverse the thrust of this Court's decision in *Southland Royalty*, *Sunray*, *First Phillips* and the *Rayne Field Cases* as well as setting aside the long-established administrative construction by the Commission in its regulations requiring explicit evidence of deliverability and reserves by producers in their sales to interstate pipelines in issuing certificates under Section 7 (18 C.F.R. §157.14). The

necessity of the Commission's jurisdiction to impose reasonable terms and conditions for the continued service of producers under committed sales to interstate pipelines is clear. Without such jurisdiction, the Commission can assure no volume of natural gas deliveries, the producers can undertake a constructive abandonment of existing committed certificate obligations, and the net impact would be, as this Court stated in the *Rayne Field* case, such a narrow interpretation of §1(b) would preclude the "[p]rotection of consumers against exploitation at the hands of natural-gas companies [which] was the primary aim of the Natural Gas Act." (381 U.S. at 402).

CONCLUSION

For the reasons set forth above, (1) the judgment of the Court of Appeals below should be reversed; (2) the decision of the Commission in Order 539–B establishing a "prudent operator" standard set aside; and (3) the case remanded to the Commission to undertake enforcement of established deliverability requirements in existing certificates and to prescribe such future deliverability requirements in all future certificates to assure consumers of continued deliveries of natural gas from committed sales.

Respectfully submitted,

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FOR ARGUMENT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

Nos. 77-1852, *Et Al.*

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner

v.

SHELL OIL COMPANY, *Et Al.*,
Respondents

On A Writ of Certiorari To The United States Court of Appeals for the Fifth Circuit

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BRIEF AMICUS CURIAE ON BEHALF OF THE STATE OF ALASKA IN SUPPORT OF RESPONDENTS

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On A Writ of Certiorari To The United States Court of Appeals for the Fifth Circuit

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BRIEF AMICUS CURIAE ON BEHALF OF THE STATE OF ALASKA IN SUPPORT OF RESPONDENTS

INTEREST OF AMICUS THE STATE OF ALASKA

Among the rich resources of Alaska are large known reserves and promising potential sources of natural gas. The Prudhoe Bay Field contains the largest accumulation of oil and gas ever discovered on the North American continent.[1] The main pool of the Prudhoe Bay field contains more than twenty trillion cubic feet of saleable natural gas.[2] The two other pools of that

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[1] Executive Office of the President, Energy Policy and Planning, *Decision and Report to Congress on the Alaska Natural Gas Transportation System*, at i (September 1977). (Hereinafter "*President's Decision*").

[2] *Id.*

field, although less well-explored, are estimated to contain 3.5 trillion cubic feet of saleable gas.[3] Cook Inlet resources, onshore and offshore, are estimated by State of Alaska officials at 18.4 trillion cubic feet.[4] No Alaska gas yet flows in interstate commerce although projects for delivery of gas from both Cook Inlet and Prudhoe Bay are being pursued at the Federal Energy Regulatory Commission (the "FERC" or the "Commission").[5]

The abundant gas resources coupled with little industry and a small population suggest that Alaska will be a fruitful source of natural gas for the interstate market.

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[3] Federal Energy Administration, Department of Commerce, Department of the Interior, Department of Transportation, Department of Treasury, Energy Research & Development Administration, *Report of the Working Group on Supply, Demand and Energy Policy Impact of Alaska Gas*, Table I-2 (July 1, 1977).

[4] State of Alaska, Division of Geological and Geophysical Survey, *Energy & Mineral Resources of Alaska, Alaska Open File Report 50*, Table I, June 1974.

[5] Small quantities of gas from Cook Inlet are used in the Anchorage area. Also, liquified natural gas from Cook Inlet is shipped to Japan, but, under well-established precedent, this movement of natural gas is "foreign," as opposed to interstate commerce, *Distrigas Corp.* v. *F.P.C.*, 495 F.2d 1057, 1062-64 (D.C. Cir. 1974), *Border Pipeline Co.* v. *F.P.C.*, 171 F.2d 149 (D.C. Cir. 1948). This export of gas was authorized by the Federal Power Commission, pursuant to Section 3 of the Natural Gas Act, 15 U.S.C. § 717b, in 1967.

Pursuant to the procedures created by the Alaska Natural Gas Transportation Act of 1976, 15 U.S.C. 719 *et seq.*, a route for the transportation of Prudhoe Bay Gas to the lower 48 states has been selected by the President and approved by the Congress. See generally *President's Decision*, *supra*. Further proceedings concerned with implementing the decision and the specific facilities needed therefore are being, or will be, conducted by the FERC and other agencies.

The State of Alaska, exercising its police powers, regulates the production of oil and natural gas through state agencies.[6] Its interest in this case is with any potential encroachment upon the proper exercise of its regulatory responsibilities. A broad ruling contrary to the Court of Appeals' opinion would hinder the development of the nationally needed oil and natural gas supplies known to exist and expected to be found in Alaska.

This concern is not mooted by the passage of the Natural Gas Policy Act of 1978 which eliminates producer sales certificate requirements from all gas not committed or dedicated to interstate commerce as of November 8, 1978, and from some other categories of committed or dedicated gas. Because Alaska gas has not yet flowed in interstate commerce, Alaska gas would not appear to be subject to the requirements of Order 539-B which arise from producer sales certificates.[7] The Staff of the FERC has, however, recently asserted that Cook Inlet gas is so committed or dedicated.[8] The State

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[6] The State of Alaska regulates all aspects of oil and gas production within Alaska so as to prevent waste, to protect correlative rights of persons owning interests in the tracts of land affected, and to ensure a greater recovery of oil and gas. This includes the right to regulate the quantity and rate of production from a well or property. ALASKA STAT. § 31.05.030(e). Prior to January 1, 1979, these powers are being exercised by the Oil and Gas Conservation Division of Alaska's Department of Natural Resources. After January 1, 1979, the Alaska Oil and Gas Conservation Commission, an independent quasi-judicial agency of the State will perform these functions.

[7] See Brief for the Federal Energy Regulatory Commission, at 15-16 (hereinafter "FERC Brief").

[8] Commission Staff Reply Brief on State of Alaska Royalty Gas Issues, FERC Docket Nos. CP75-140, *et al.*, November 21, 1978, at 7.

of Alaska believes this view is incorrect and has so informed the Commission. Because of the dispute over Cook Inlet Gas, and an inability to predict how expansively the Commission will seek to interpret its remaining power over producer sales under the Natural Gas Act, Alaska is concerned with the possible interference with fundamental state powers that could result from the Court's holding.

ARGUMENT

THE COURT OF APPEALS' OPINION SHOULD BE AFFIRMED BECAUSE IT RESPECTS, AND GIVES FORCE TO, THE STATUTORY BALANCE BETWEEN STATE AND FEDERAL REGULATION

1. The Natural Gas Act Was Carefully Drawn To Preserve State Control Over Production and Gathering

The Natural Gas Act was drawn by Congress to occupy a field in which the Supreme Court had held* that the states may not act: interstate sales and transportation of natural gas. *See,* H.R. No. 709, 75th Cong., 1st Sess., 1-2; S.R. No. 1162, 75th Cong., 1st Sess., 1-2; *Phillips Petroleum Company* v. *Wisconsin,* 347 U.S. 672, 683-4 n. 13 (1954). This dominant purpose did not extend to the physical acts of drawing natural gas from the earth and preparing it for transportation for these were not thought to be proper subjects of federal regulation and there was no pattern of abuses which called for legislative relief. Indeed, at the passage of the Natural Gas Act, production and gathering were commonly understood to be functions properly regulated by the states, and no question then had been

* *Missouri* v. *Kansas Gas Co.*, 265 U.S. 298 (1924); *Public Service Commission* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927).

raised of the effectiveness or propriety of state regulation. *See Champlin Refining Co.* v. *Corporation Commission of Oklahoma,* 286 U.S. 210, 235 (1932). For these reasons, regulation of production and gathering was expressly excluded from the Commission's reach.

The legislative purpose was to create a comprehensive statutory scheme of *federal* regulation of interstate sales and transportation and of *state* regulation of production and gathering. Both federal and state powers were needed to create the comprehensive whole.

This purpose has been recognized and consistently expressed in the decisions of the Court. In *F.P.C.* v. *Louisiana Power & Light Co.,* 406 U.S. 621 (1972), for example, the Court stated:

> "To that end, Congress 'meant to create a comprehensive and effective regulatory scheme,' *Panhandle Eastern Pipeline Co.* v. *Public Service Commission,* 332 U.S. 507, 520 (1947), *of dual state and federal authority.* Although federal jurisdiction was not to be exclusive, F.P.C. regulation was to be broadly complimentary to that reserved to the states, so that there would be no 'gaps' for private interest to subvert the public welfare." (406 U.S. at 631) (emphasis added).

The importance of State regulation to the federal scheme also has been recognized in the decisions of the Court. In *United Gas Improvement Co.* v. *Continental Oil Co. ("Rayne Field"),* 381 U.S. 392, 403 (1965), the Court stated:

> "The 'production or gathering' exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the land affirmatively subject to Commission jur-

isdiction. This accommodation of the two relevant clauses of § 1(b) gives content to the potential objectives of the Natural Gas Act as expanded in *Phillips*, and to the Commission's jurisdiction to accomplish them, *while in no way interfering with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate state concerns.*" (emphasis added).

2. Order 539-B Invades the Production or Gathering Exemption

The central question before the Court is whether Order 539-B, and the arguments in support of it advanced by the FERC, properly respect the legitimate areas intentionally reserved for state regulation by Congress in Section 1(b) of the Natural Gas Act and by the decisions of the Court construing that Section. The Court's decision on this issue must harmonize the respective state and federal interests expressed in Sections 1(b) and 7,[10] consistent with the Court's responsibility to give meaning to all parts of a statute.[11]

Little time need be spent on whether the activity to be brought within the ambit of Commission power by Order 539-B directly concerns production and gathering. What Order 539-B concerns is not activity *incidental* to the physical acts of drawing forth gas from

[10] Both Sections 1(b) and 7, it must be recalled, express constitutional powers which underscore the necessity of a proper balancing of those interests in this case.

[11] " 'The cardinal principle of statutory construction is to save and not to destroy.' . . . It is our duty 'to give effect, if possible, to every clause and word of a statute,' . . . rather than to emasculate an entire section. . . ." *United States* v. *Menasche*, 348 U.S. 528, 538-39 (1955) (citations omitted).

the earth and gathering it, but production and gathering themselves:

> "[*The prudent operator*] *standard encompasses* the obligations to develop the properties consistent with the performance requirements of lease agreements, *all valid rules and regulations of any Federal, state or local government having jurisdiction; and the standard of what a reasonably prudent producer would do with respect to the drilling*[,] *completion, workover, recompletion or abandonment of wells.*" 41 Fed. Reg. at 32884. (emphasis added).

And, the established meaning of the standard encompasses *all* operations of a producer, including the rate of offtake, development, methods of gathering, etc. *See generally* H. Williams and C. Meyers, *Oil and Gas Law*, § 806 *et seq.*, at 27 *et seq.* (1977).

The FERC has endeavored to defuse state concerns by the suggestion that state law is the "yardstick" by which compliance will be measured.[12] FERC Brief at 33. But it appears that FERC is not imposing a requirement of following state determinations, it is im-

[12] The FERC expressly recognizes that state law determines the responsibilities of the producer under the standard:

> "Far from conflicting with legitimate state regulatory requirements, the prudent operator standard expressly encompasses those requirements and constitutes the very standard under which the producers claimed they were already operating . . .
>
> "*This standard does not imply federal obligations different from those imposed by the states either under the terms of leases or under state conservation laws. On the contrary, it is to be administered with reference to those state standards.* The Commission's standard simply requires that the producer operate in accordance with established practice and with requirements adopted by the jurisdiction exercising direct regulation over the production." (FERC Brief at 31-32).

posing an independent requirement paralleling state requirements; an independent requirement for which FERC determines compliance or non-compliance. If the FERC has authority to impose a standard, albeit adopted from state law, it will argue that it has primary authority in its application in a particular case.[13] Practically, the FERC would have final and complete authority over all state laws concerning production and gathering activities insofar as those laws affect producers supplying gas to the interstate market under Section 7 certificates.

The potential for conflict is well near inevitable. The FERC's own description of the areas it desires to control is illustrative of the large arena for disagreement between the FERC and a state over particular applications:

> "If a certificated producer *unreasonably* shuts in its wells or *otherwise unreasonably* reduces production; or *fails to take prudent steps* to maintain its equipment, so that production and delivery cease *through simple neglect*; or fails to develop its dedicated properties in accord with the *requirements of its lease and applicable state law*, it has effectively abandoned service without the Commission's approval." (FERC Brief at 22) (emphasis added).

As we shall argue below, the reach of the Commission's powers under Section 7, though great, does not extend to activities encompassed within the exclusion of Section 1(b). Thus, the Commission cannot embrace basic production and gathering decisions, as it proposes to do, within Section 7, without frustration of

[13] See, e.g. Brief of Petitioner Consumer Energy Council of America, pp. 57-58, n.36.

the Congressional intent, and violation of the statutory scheme.

To be sure, Congress could have committed these matters exclusively to federal regulation, but chose not to. And no issue has been raised of state regulation burdening or discriminating against interstate commerce. None could be raised for what are involved are garden-variety state conservation decisions—well-suited to state regulation by their nature and intentionally left to the states by Congress.[14] The wisdom of the statutory scheme is reaffirmed by the nature of the regulatory judgments state authorities are called upon to make. These judgments can encompass trade-offs between oil and gas production from a single field, between immediate production and ultimate recovery, and between the risk of field damage from secondary or tertiary recovery techniques and the benefits of higher ultimate recovery.

Alaska does not contend that a regulation concerning supply could not be drawn that would not intrude on the production or gathering exemption, for the Court concededly has held that that exemption must be narrowly construed and the Commission has legitimate concerns with supply. *Interstate Natural Gas Co. v. F.P.C.*, 331 U.S. 682, 690-691 (1947). Even under the narrowest possible construction of the production or gathering exemption, however, the wholesale adoption of state laws over all producer activities, with provision for the FERC determination of the application of those standards, must inevitably violate the Act.

[14] E.g., *Bayou Field*, *supra*, 381 U.S. at 402 ("... while in no way interfering with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other state concerns.") (emphasis added).

3. The Decisions of the Court Do Not Support the Commission

The crux of the Commission's argument is that the affirmative grant of jurisdiction contained in Section 7 carries with it the power to control the actions of certificate holders even as respects production activities should those actions bear upon the "national objectives" of the Act. FERC Brief at 23-30. The Commission suggests that the exemption of Section 1(b) does not limit Section 7 powers and the protection for State regulatory powers embodied in Section 1(b) must give way in the face of national objectives and the Commission's power to enforce certificate requirements. FERC Brief at 23-30. The Commission does not give a fair reading to the Natural Gas Act or its legislative history.

First, although the Committee reports, described in *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672 (1954), state that language expressing the production or gathering exemption was not thought essential, the conclusion was reached not because production and gathering were not thought to be reserved to the states, but because production and gathering "could not be said fairly to be covered by the language affirmatively stating the jurisdiction of the Commission." H. R. Rep. No. 709, 75 Cong., 1st Sess. No one then foresaw the expansive reading of Section 7 powers now urged. The production or gathering exemption did not limit Section 7 powers because Section 7 powers never were intended to reach production and gathering. It cannot fairly be contended that where the direct extension of Commission sales and transportation jurisdiction to production and gathering is proposed, expressions of legislative intent based upon a premise of statutory harmony between those powers are in any way applicable. Further, the language of the Natural Gas Act,

as adopted, did contain the exclusion and the Court must give meaning to all parts of the statute.

Second, no support for the Commission's view can be found in the trilogy of cases involving *sales* transactions which the Commission has cited. FERC Brief at 25-30. For while the assertion was there made that the various forms of sales transactions were part of production and gathering, the Court did not have before it transactions which go to the heart of the production or gathering exemption, but with transactions which were, in form, sales, or efforts to escape the Commission's sales jurisdiction.[15]

No argument can be made here that a sales transaction is at issue. However narrowly the exemptions to Section 1(b) may be construed, they must be left with a core of meaning. It is that core which is invaded by the Commission's assertion of jurisdiction over production. A decision about the proper level of activity or the failure to develop properly a producing field is the essence of a conservation decision and not one at the periphery of production powers.

Rayne Field, supra, is not to the contrary. Although the sales there occurred "before" production started, the Court was concerned with a form of sales transaction or, some would say, an attempt to evade sales jurisdiction. There was no contention, however, that the sale

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[15] The issue before the Court is not one of concern with state regulation which directly or indirectly subverts the price regulation of interstate sales committed undeniably to federal power. The issues raised by *Northern Natural Gas Co.* v. *State Corporation Commission of Kansas,* 372 U.S. 84 (1963), therefore, are not present here. For the part of the Court of Appeals holding and the Commission's Order with which Alaska is concerned is that which embodies and adopts state regulatory standards to measure reasonably prudent operation.

of leaseholds was itself a production function. The Court's language that a sale "before production or gathering is ended" is "nonetheless subject to regulation" (381 U.S. at 402) in no way diminishes the legitimate exclusion of Commission regulation over *production* and *gathering* themselves. The very language cited by the Commission from *Rayne Field* emphasizes the maintenance of the state's powers over the physical activities, processes and facilities of production or gathering. FERC Brief at 27-28.

The Commission's Brief never squarely faces the question what would remain of the production or gathering exemption if its position prevails. If Order 539-B is upheld, the states would be shorn of their power to regulate production and gathering except insofar as such production and gathering are confined to those categories of gas from which Section 7 requirements have been removed by the Natural Gas Policy Act of 1978. The production or gathering exemption has greater meaning than the Commission would allow.

The State of Alaska does not contend that the Commission lacks power to enforce the obligations of producers to continue the service of delivering gas from dedicated reserves. The Commission, however, has chosen a regulatory scheme which invades powers reserved to the states. The Commission is not powerless to achieve its goals, but the particular path it has chosen is not consistent with the statutory language, the Congressional intent, or a realistic balance between the appropriate responsibilities of the state and Federal governments.

* * * * *

The arguments of the *amici* supporting the Commission may be reduced to the basic contention that there

is a need for federal regulation of gas supply obligations. It appears that this argument is not persuasive for Congress has recently legislatively removed from much natural gas Section 7 type regulation. FERC Brief at 15-16. Thus, the perception that there is a need for enlarged regulatory powers is not shared by those who give the Commission its legal powers. Moreover, even if the need does exist, "a *need* for federal regulation does not establish FPC jurisdiction that Congress has not granted." *F.P.C.* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 635-636 (1972). The Commission should endeavor to satisfy whatever legitimate concerns it has with supply within the statutory framework of the powers granted it by Congress, and not by interference with powers expressly reserved to the states.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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